



Quarterly Meeting and Conference Call April 30, 2009

Office of the Arizona State Treasurer
Treasurer Dean Martin



HON. DEAN MARTIN, TREASURER

OFFICE OF THE ARIZONA STATE TREASURER



AGENDA

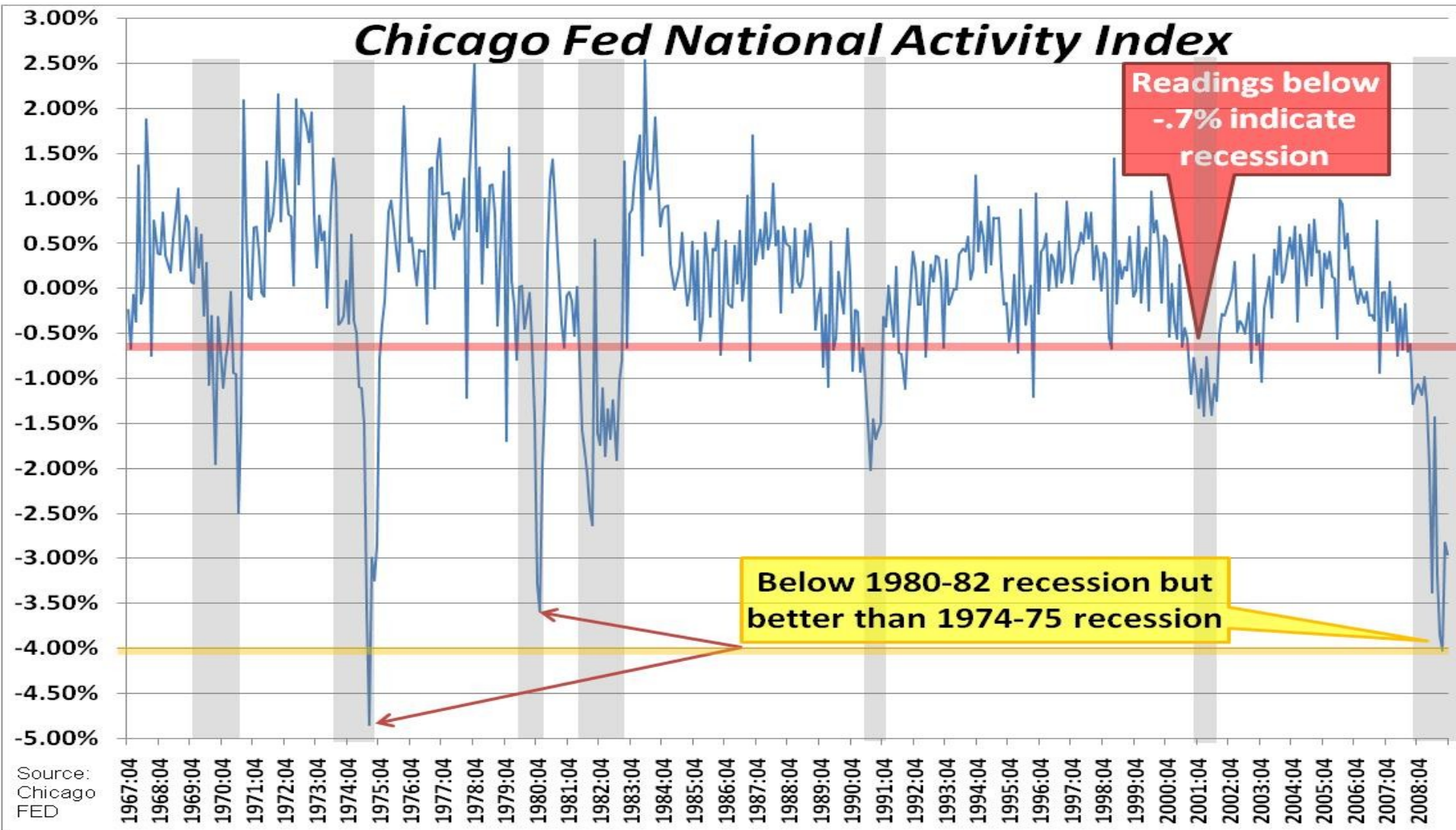
April 30, 2009

- Economic Outlook
- Interest Rate Outlook
- LGIP Update
- Legislative Update
- Endowment Update
- Q & A

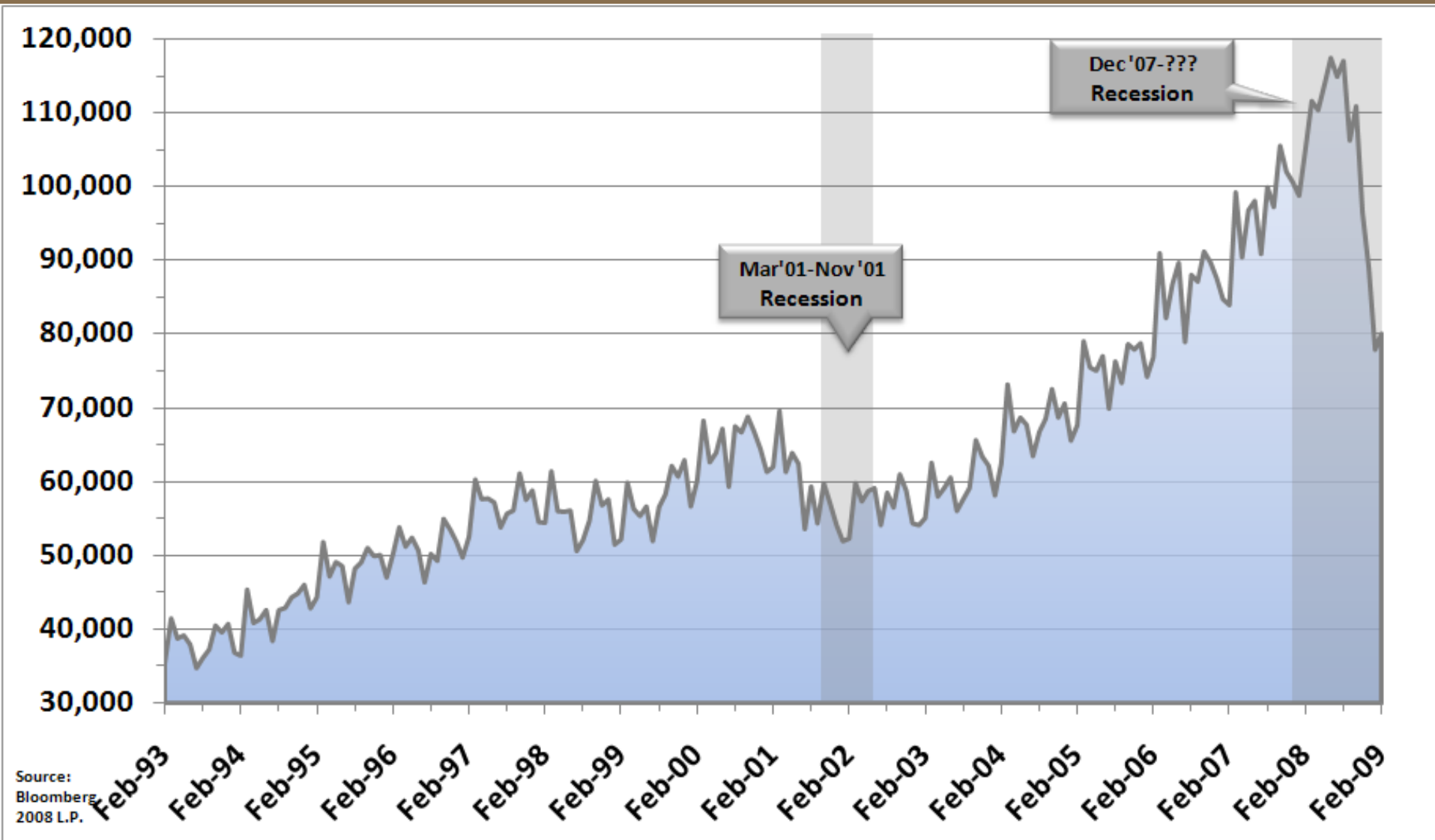




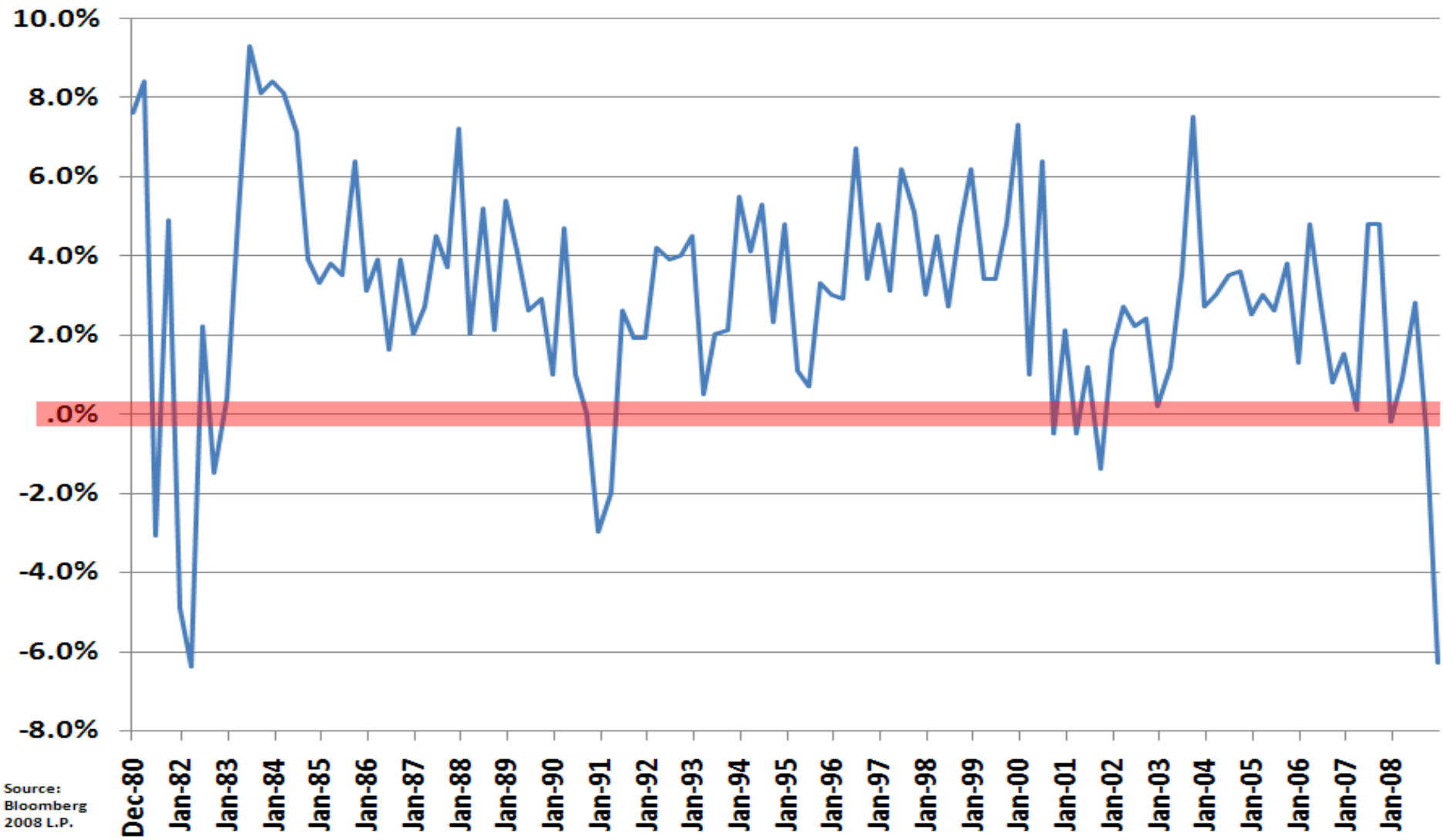
US Recession is now 17 months old



US Exports plunge in second half of 2008



Quarterly change in GDP



Continuing Jobless Claims as a % of Non-Farm payrolls. Better than 1974-75 or 1980-82 recession levels (so far)



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Change in Net Worth at lowest level since records began in 1952



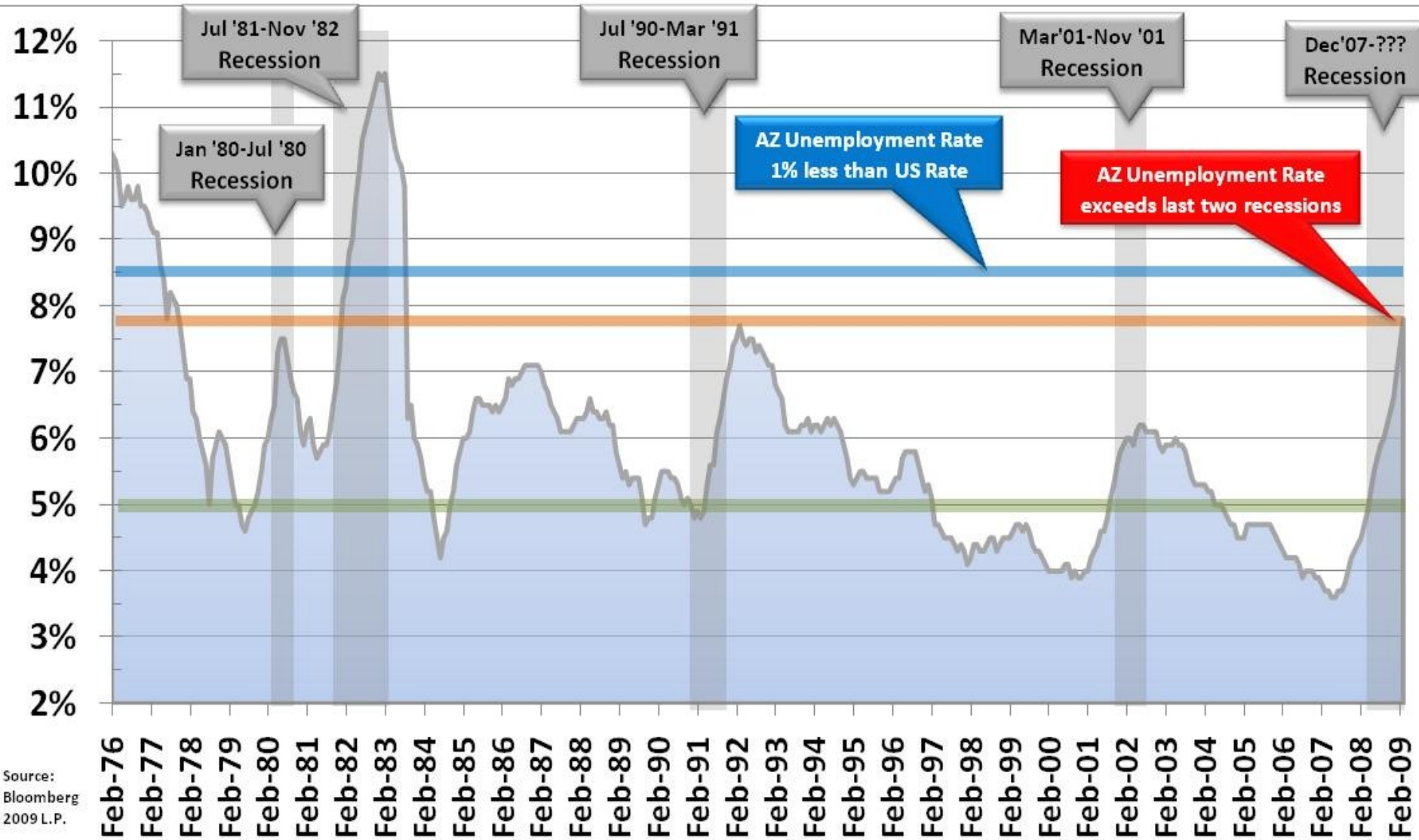
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Pg 8

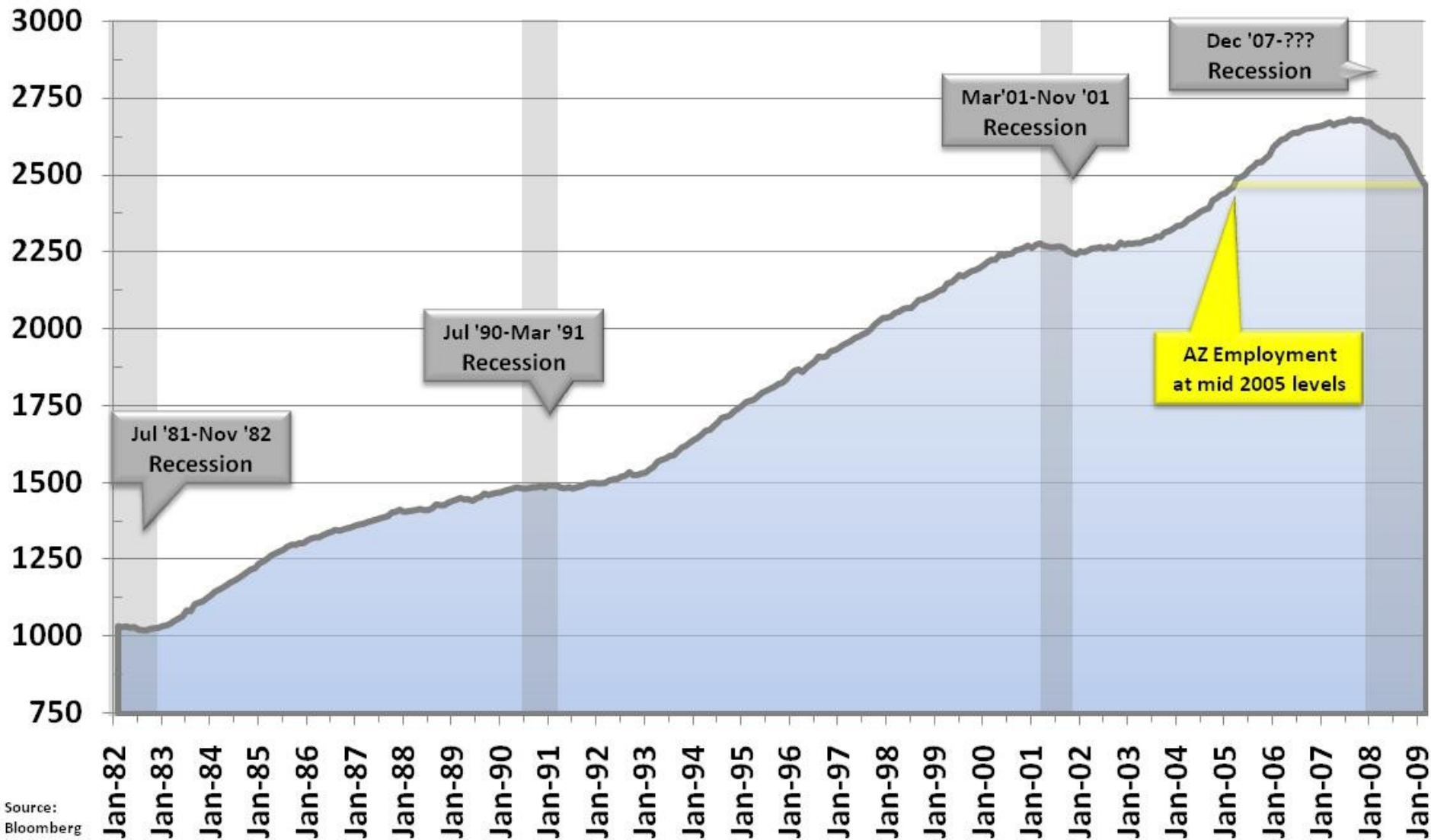
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AZ Unemployment



AZ Non-Farm Jobs



Source:
Bloomberg
2009 L.P.



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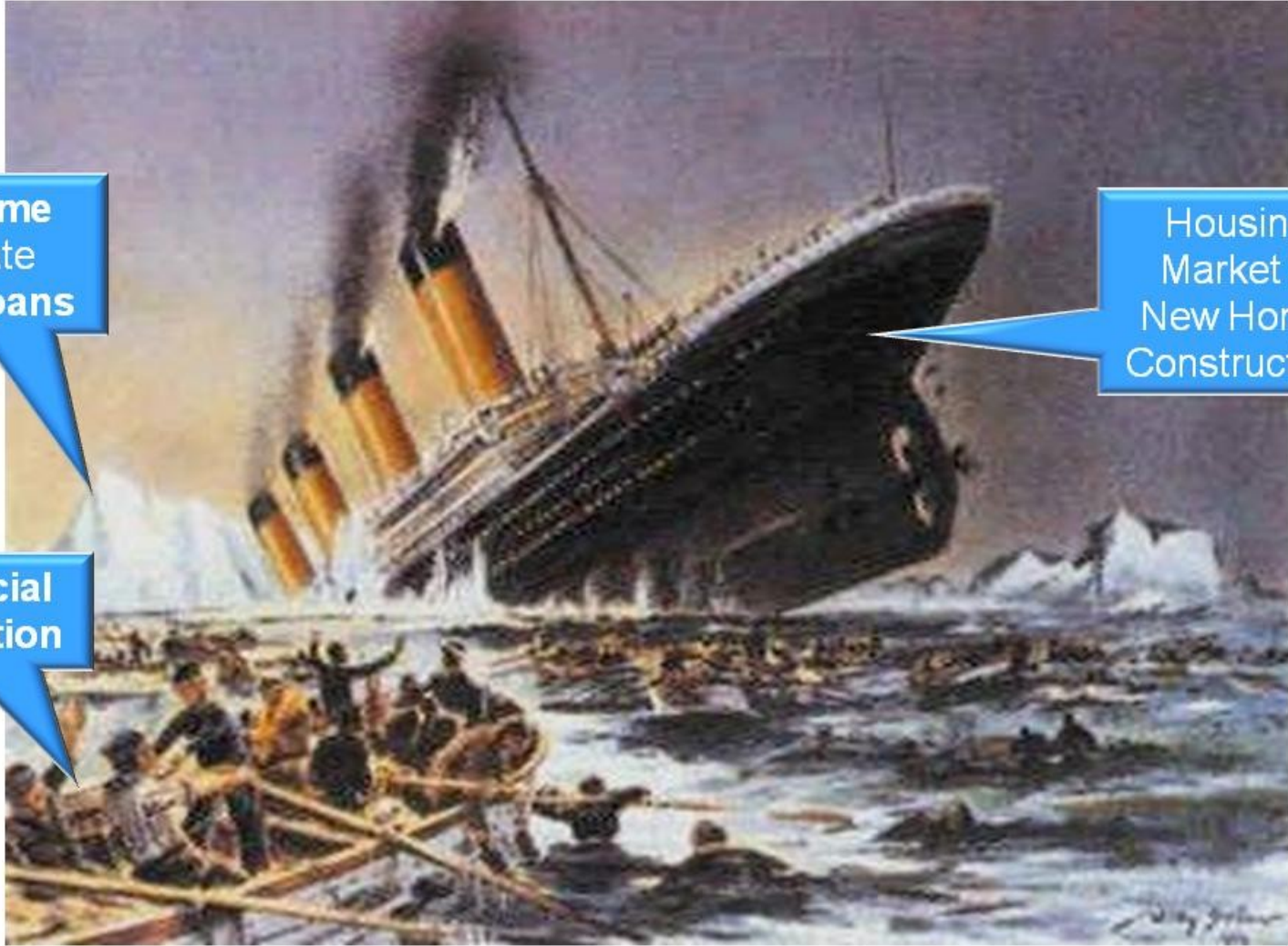
Housing & Construction

Previous Outlook

Sub-prime
High-rate
NINJA Loans

Commercial
Construction

Housing
Market &
New Home
Construction

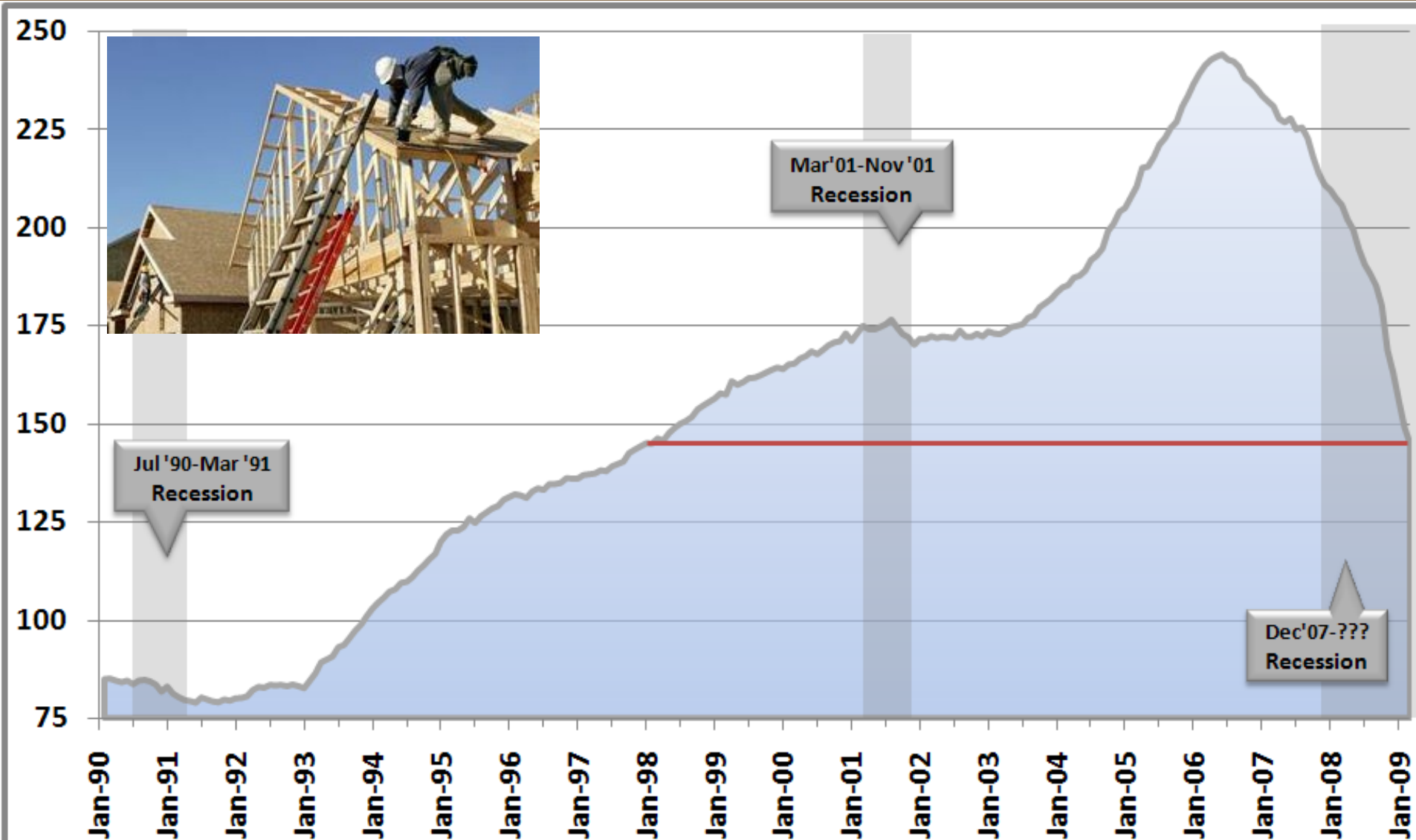


Housing & Construction

Current Status



AZ Construction Employment at 1998 levels!



Source: Bloomberg 2009 L.P.



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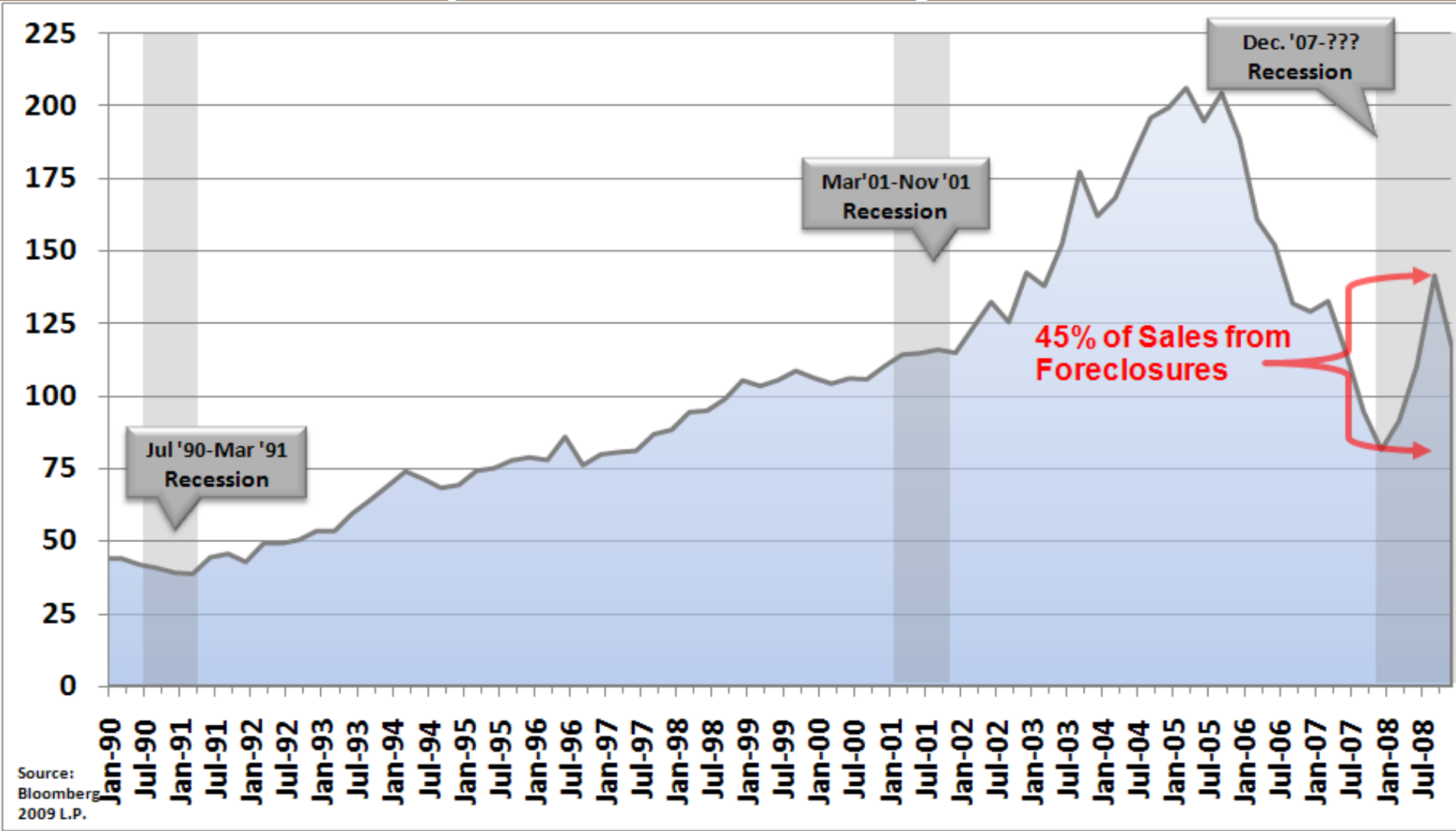


Signs of spring on the horizon?



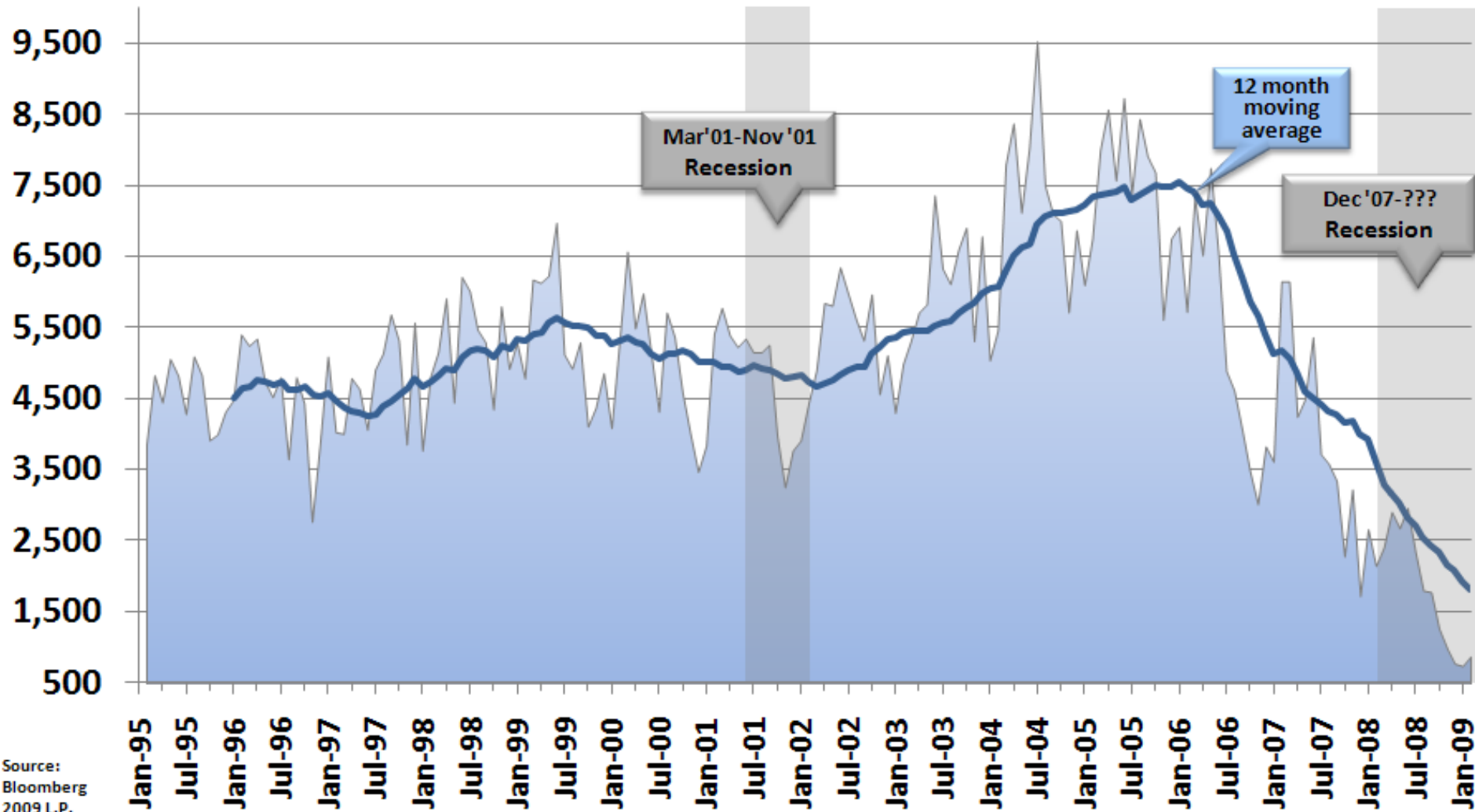
Arizona Sales of Existing Homes Moving Up

Quarterly Data Jan. 90 through Dec. 2008



Arizona Housing Permits: Nearing a Bottom?

Total Monthly Arizona Residential Building Permits 1995 to Feb. 2009



Source:
Bloomberg
2009 L.P.



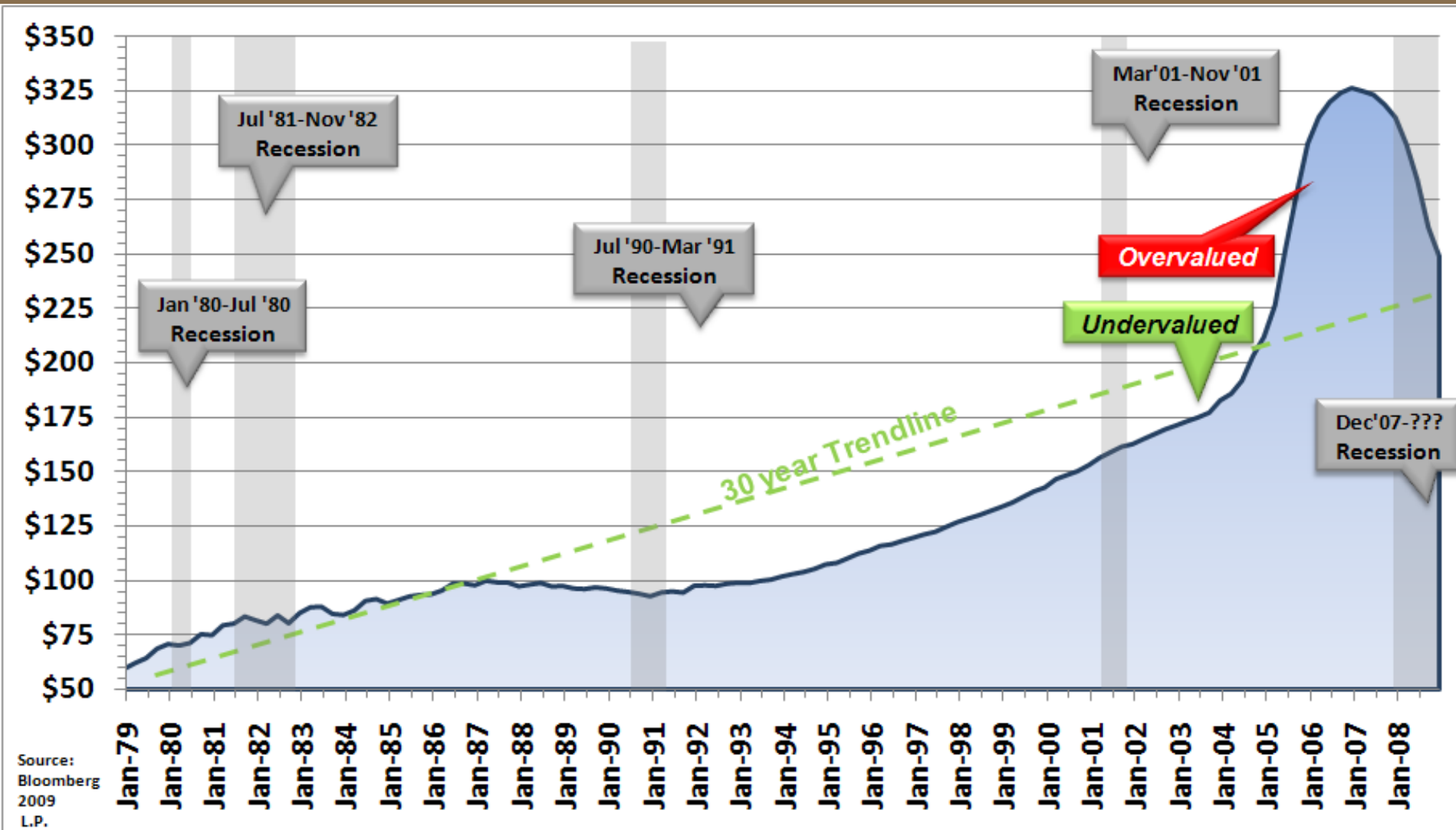
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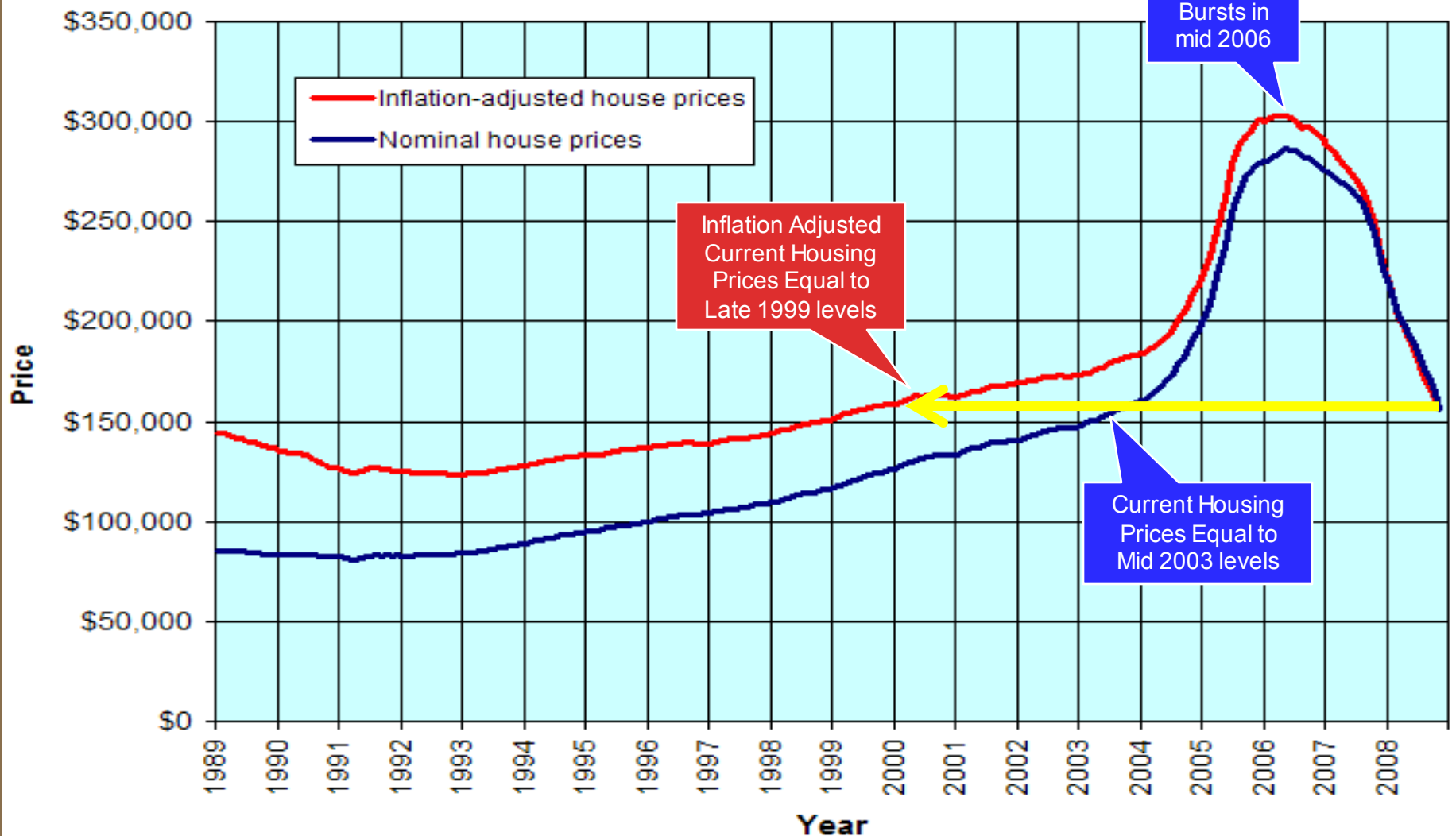
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AZ Conventional Mortgage Price Index for Valley



Phoenix, Arizona Metropolitan Area House Prices



Latest quarterly, median, existing, single-family home price provided by the National Association of Realtors. Trailing house price index data provided by Standard & Pools.

Inflation data provided by the Federal Reserve Bank of Cleveland.

The chart on this page estimates the market value of today's median-priced house over time. The trailing nominal prices are derived by taking the recent median price of existing single-family homes, as reported by the National Association of Realtors, and discounting it by the S&P/Case-Shiller Home Price Index. The S&P/Case-Shiller HPI is a "constant quality" index, so even though houses are built larger today than they were many years ago, this graph automatically adjusts for this variation. The trailing inflation-adjusted prices are then derived by adjusting the nominal prices by the *CPI-U Research Series Using Current Methods*.

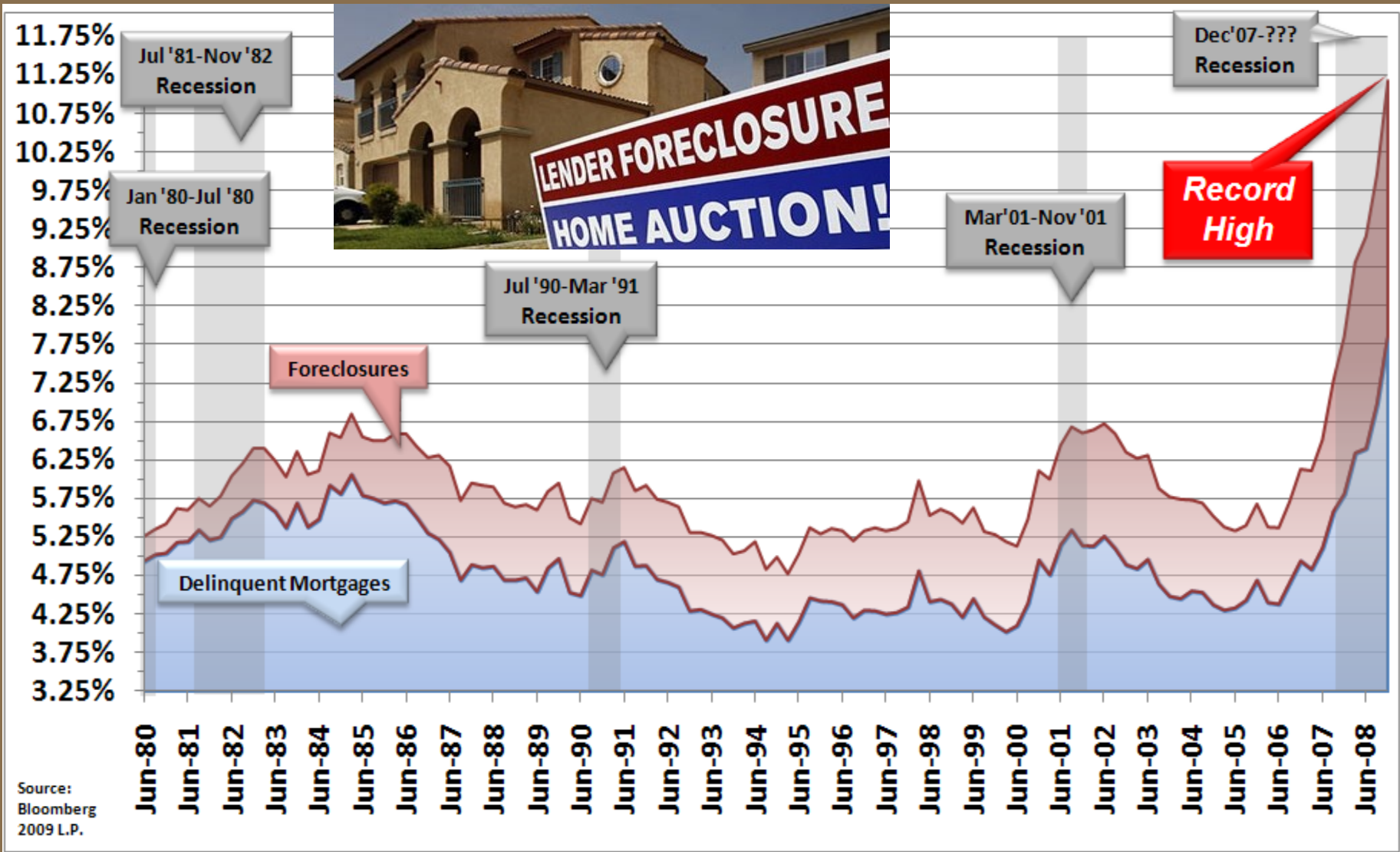
<http://mysite.verizon.net/vzeqrguz/housingbubble/phoenix.html>



Arizona still Over Stocked on Homes, but improving



11% of US Mortgages Distressed



Commercial Property Bubble Bursting Now



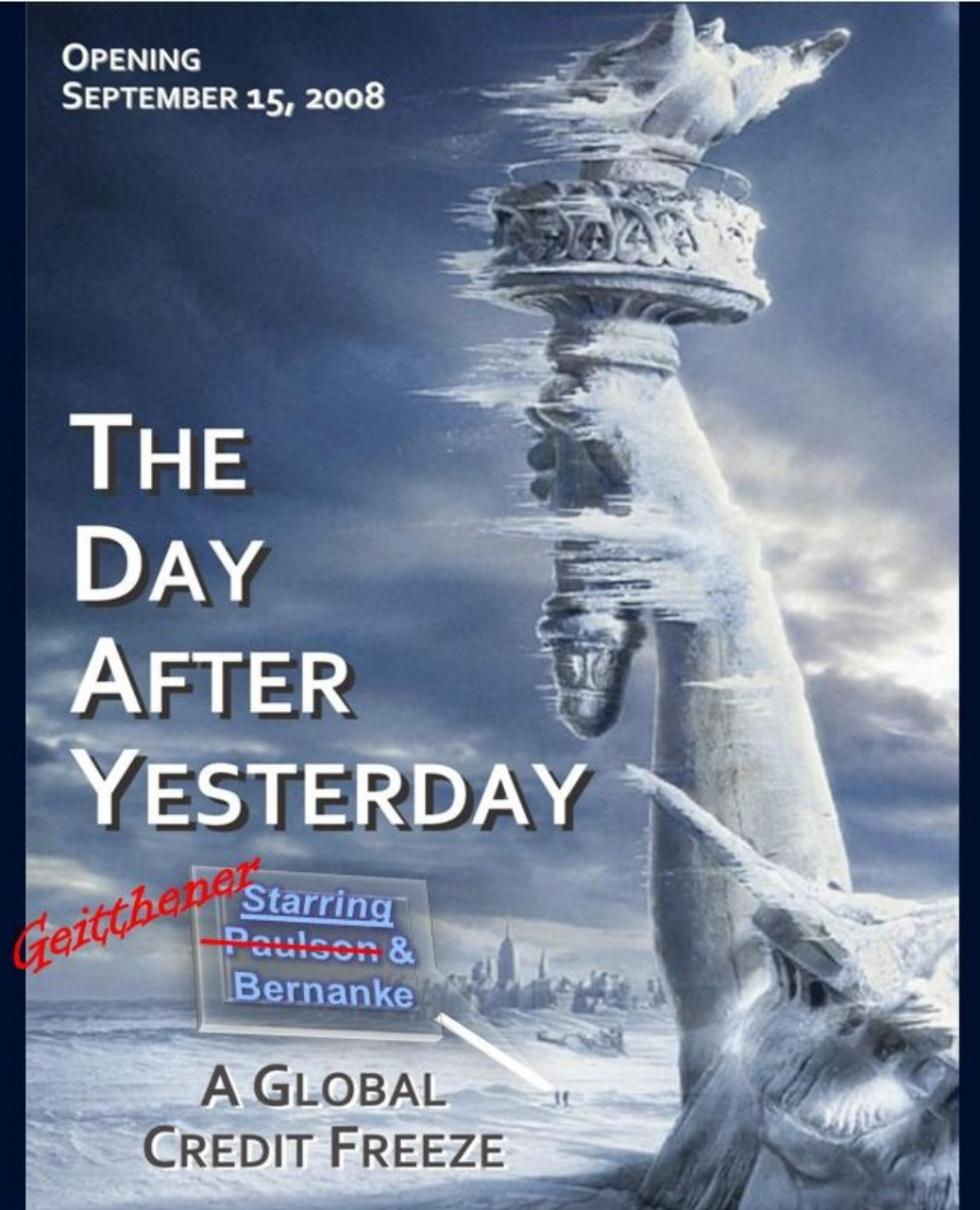
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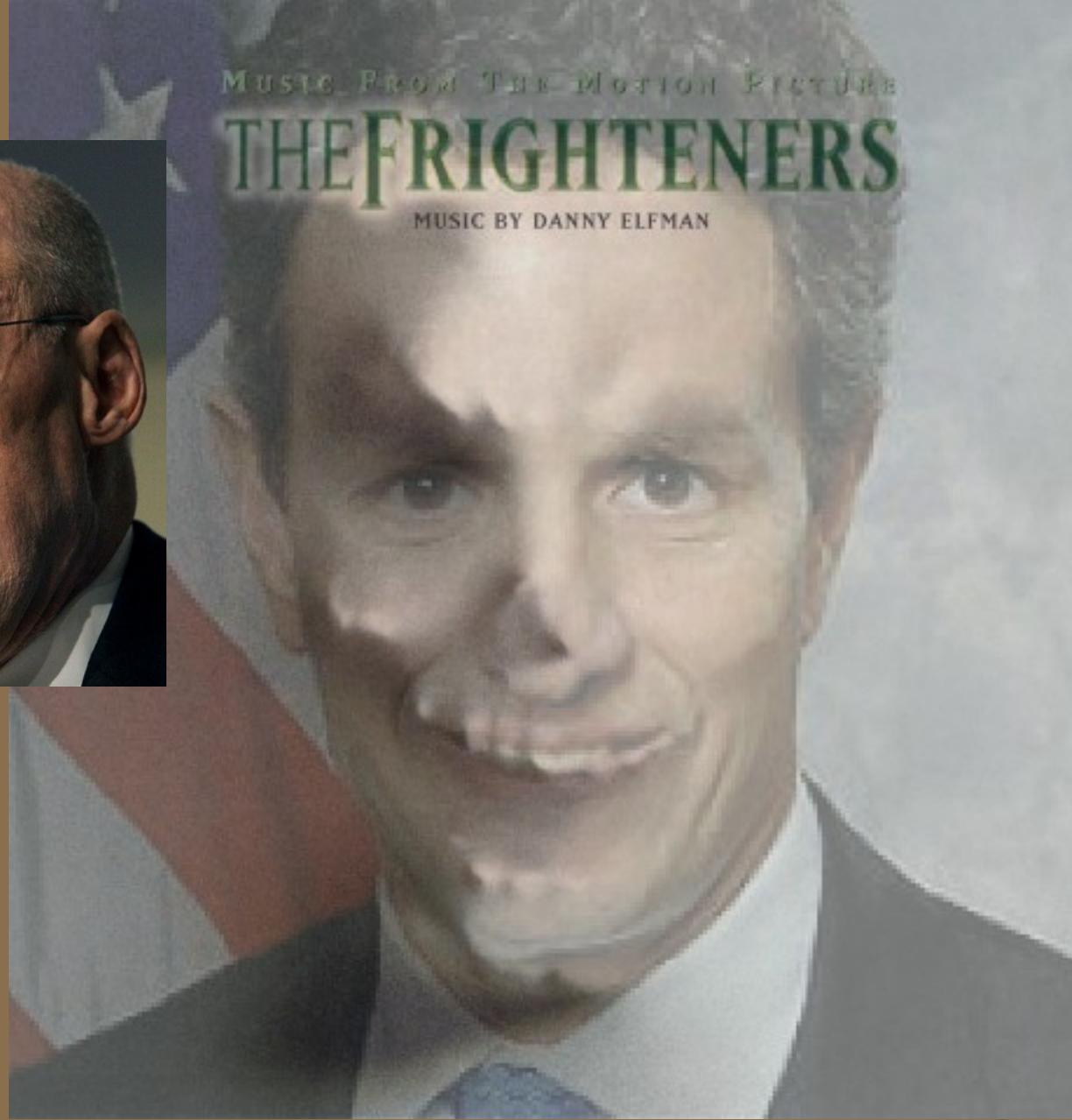
A New
Movie
From the
Government
that Brought
you last year's
smash:



***Starring
Treasury
Secretary
Timothy
Geithner***



Also Starring



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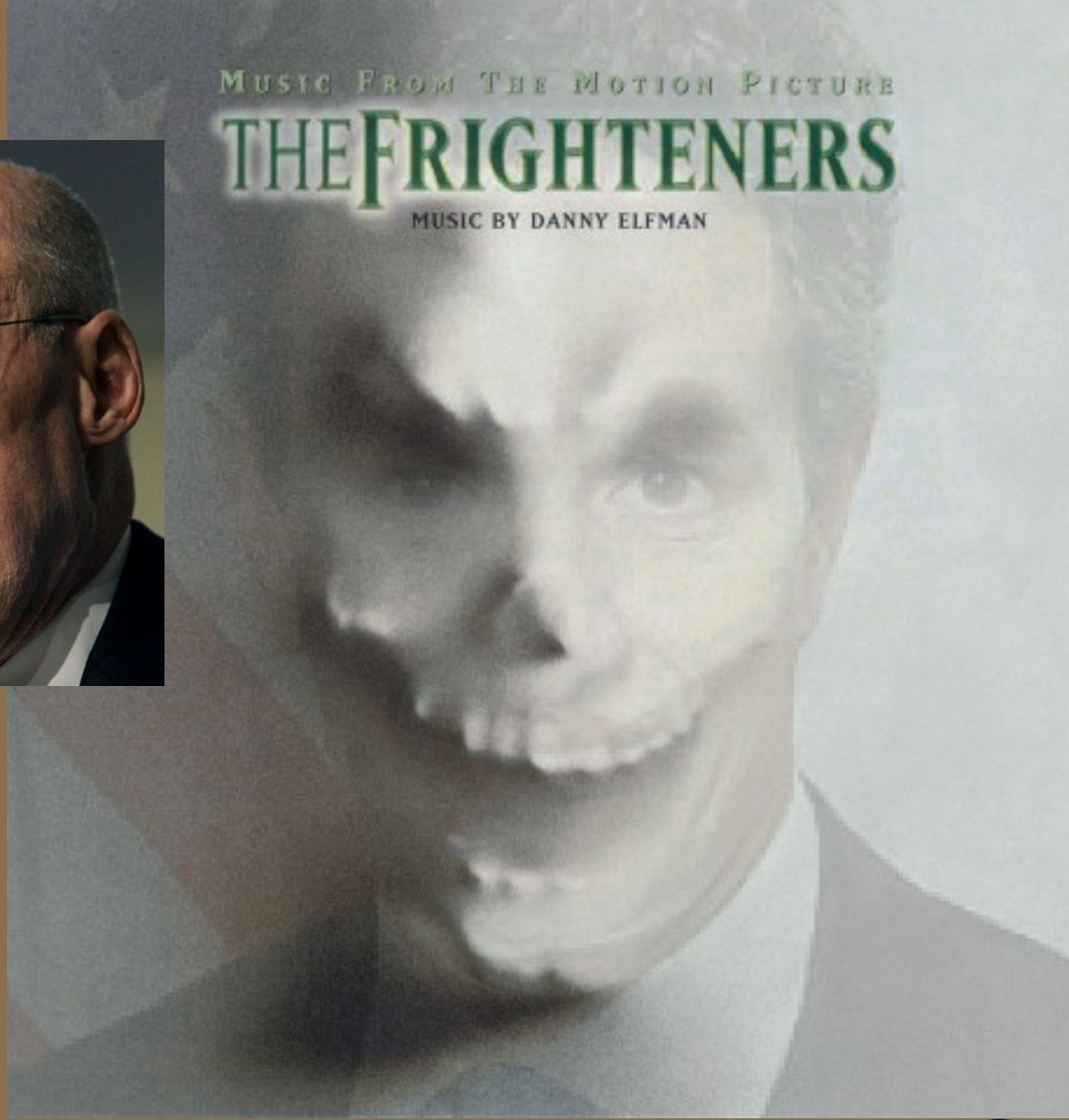
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Also Starring



MUSIC FROM THE MOTION PICTURE
THE FRIGHTENERS
MUSIC BY DANNY ELFMAN



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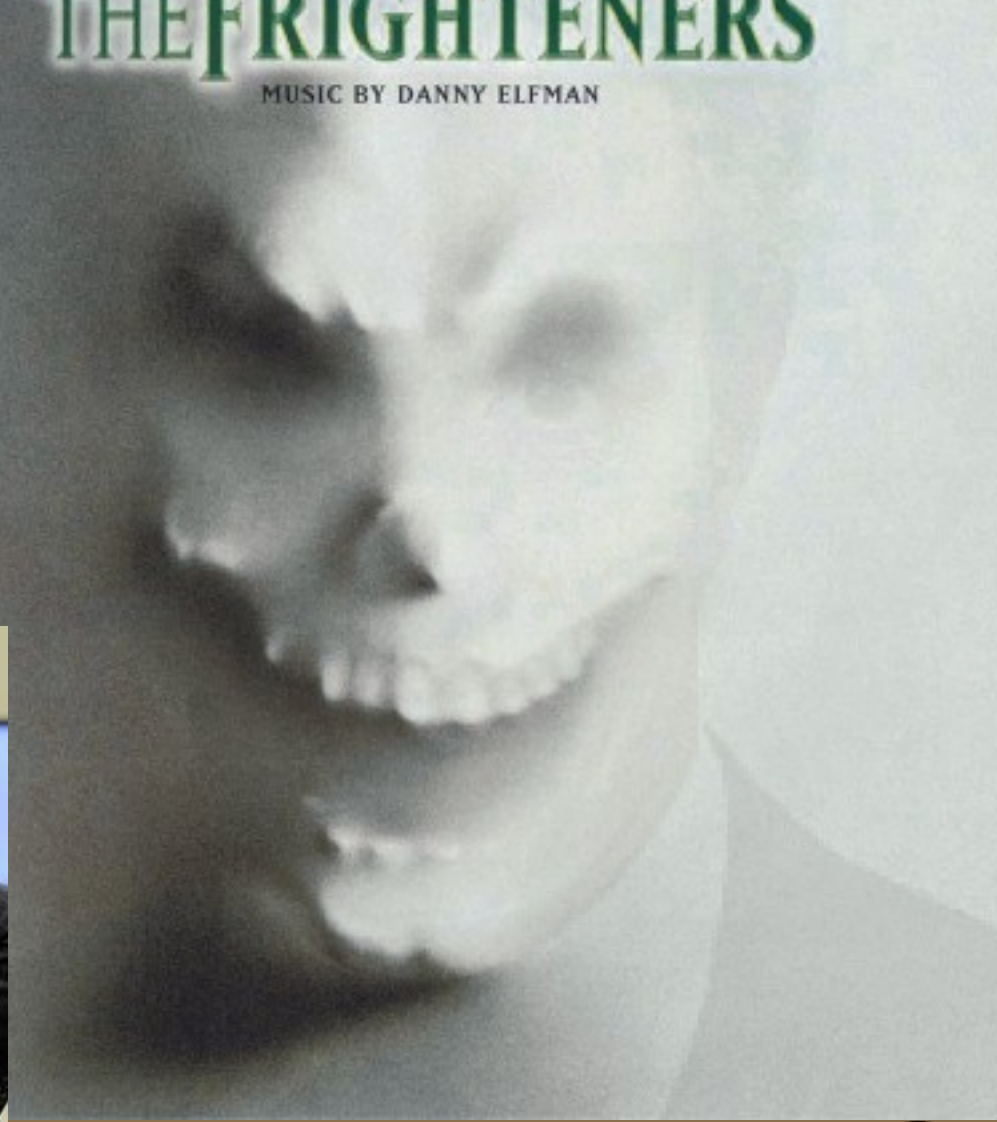
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Also Starring

MUSIC FROM THE MOTION PICTURE
THE FRIGHTENERS
MUSIC BY DANNY ELFMAN



When Timmy Speaks...



People Listen.



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Which
led to:



DOW, S&P 500 & 400 Quarterly since 1980



US Stock Markets

DOW, S&P 500, S&P 400



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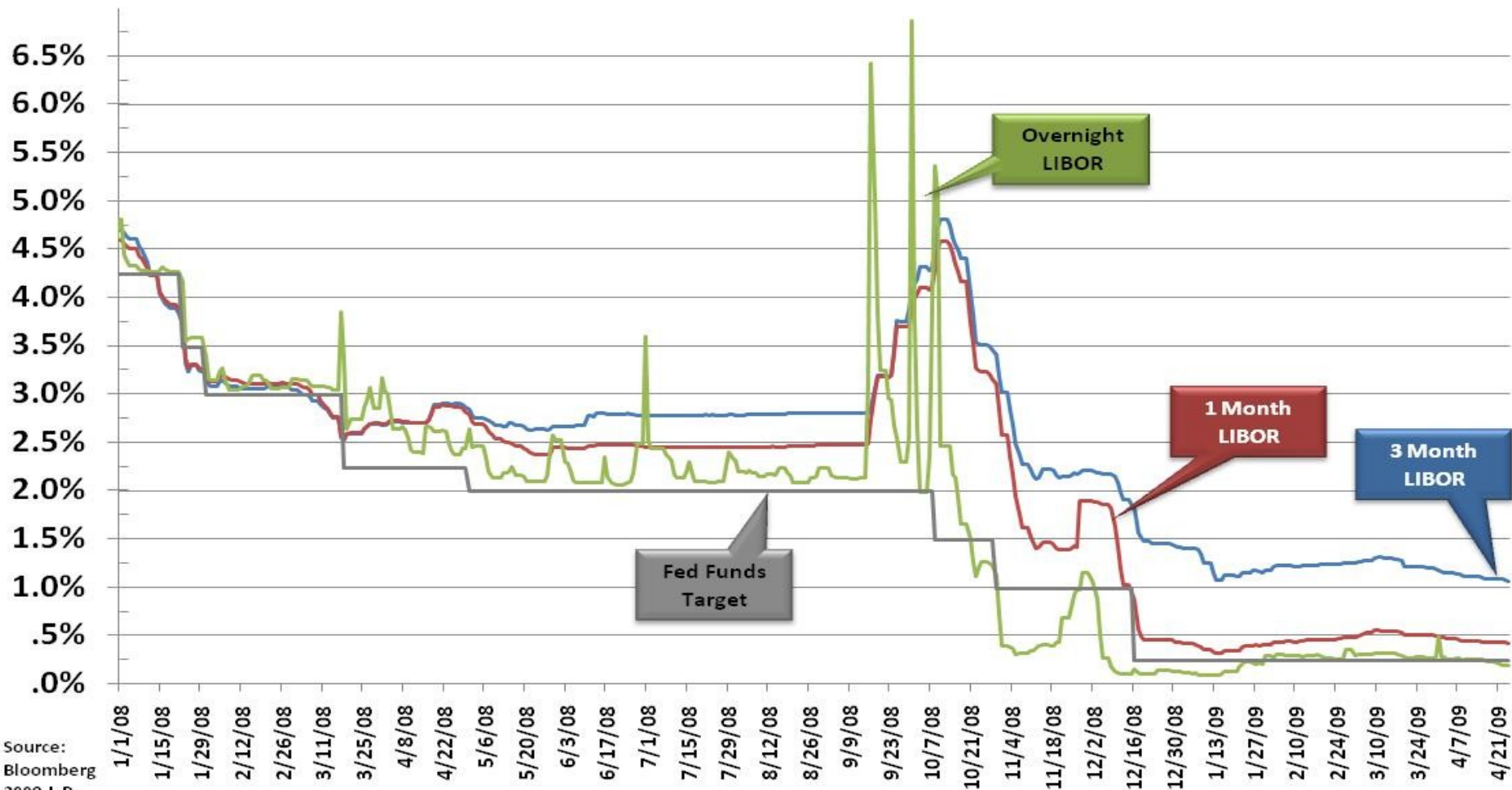


In October we forecasted the credit freeze would ease to “regular credit crunch” by year end.

3-month LIBOR vs overnight swap rate (spread)



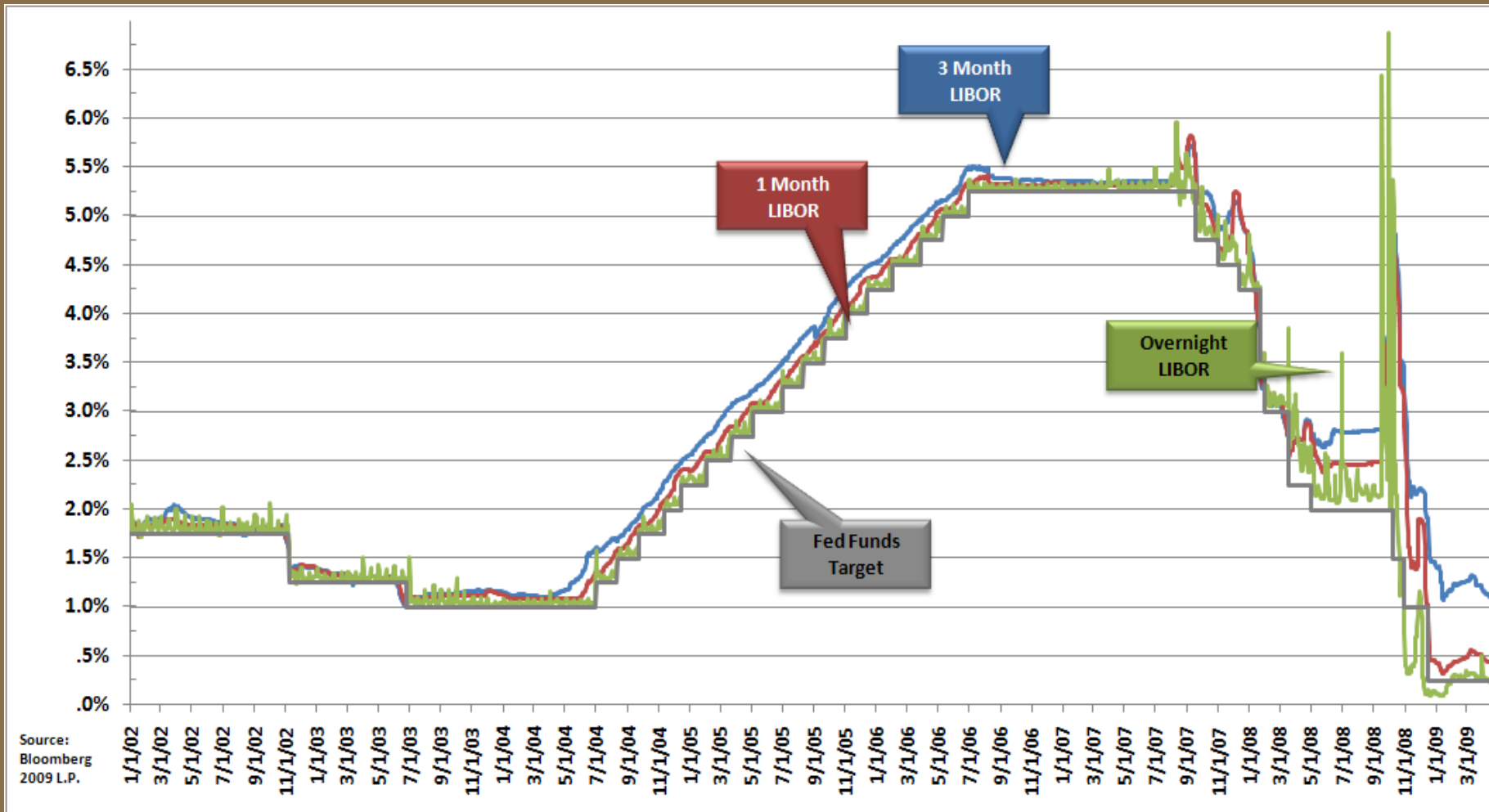
Measuring The Freeze LIBOR vs Fed Funds



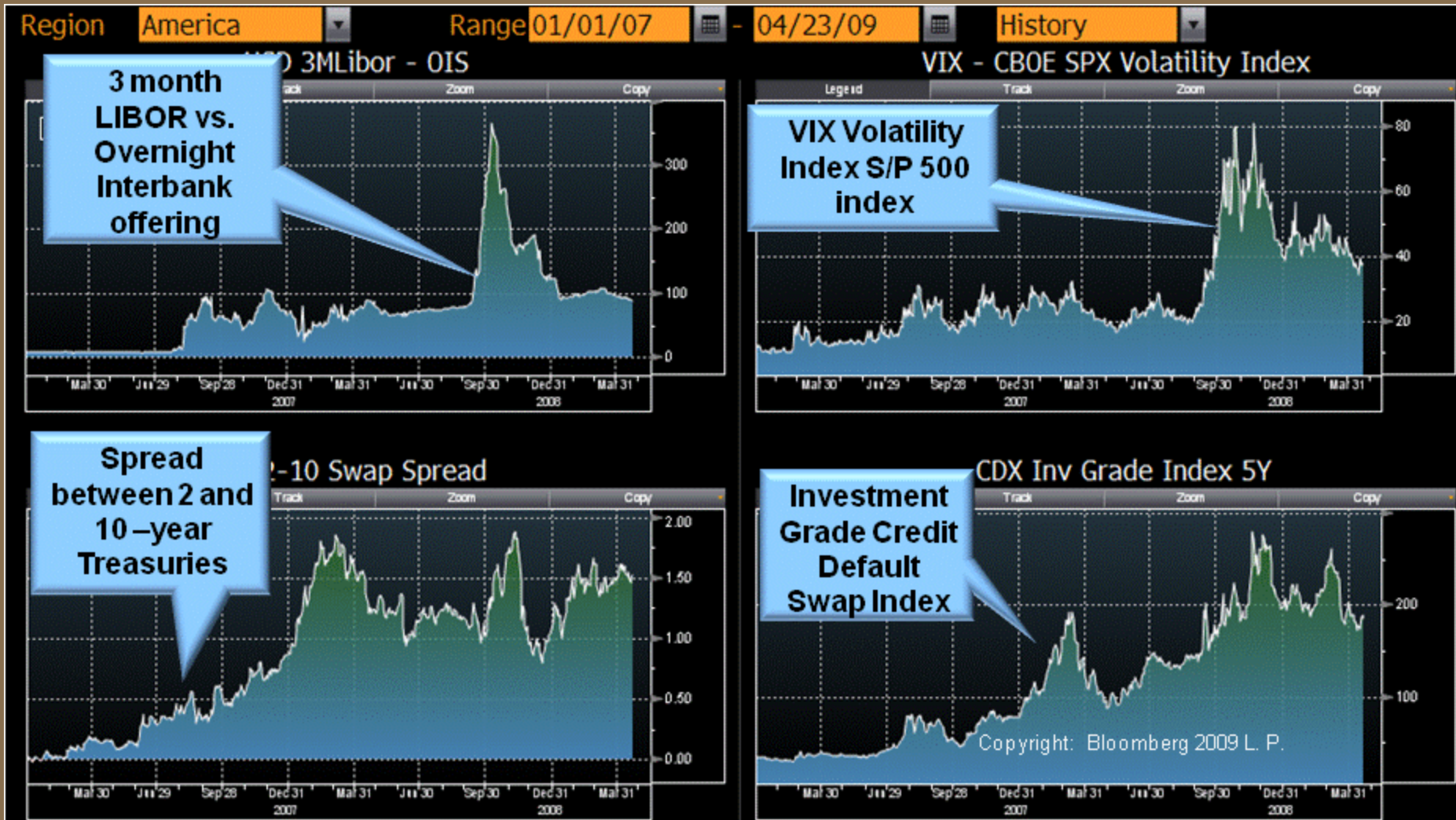
Source:
Bloomberg
2009 L.P.



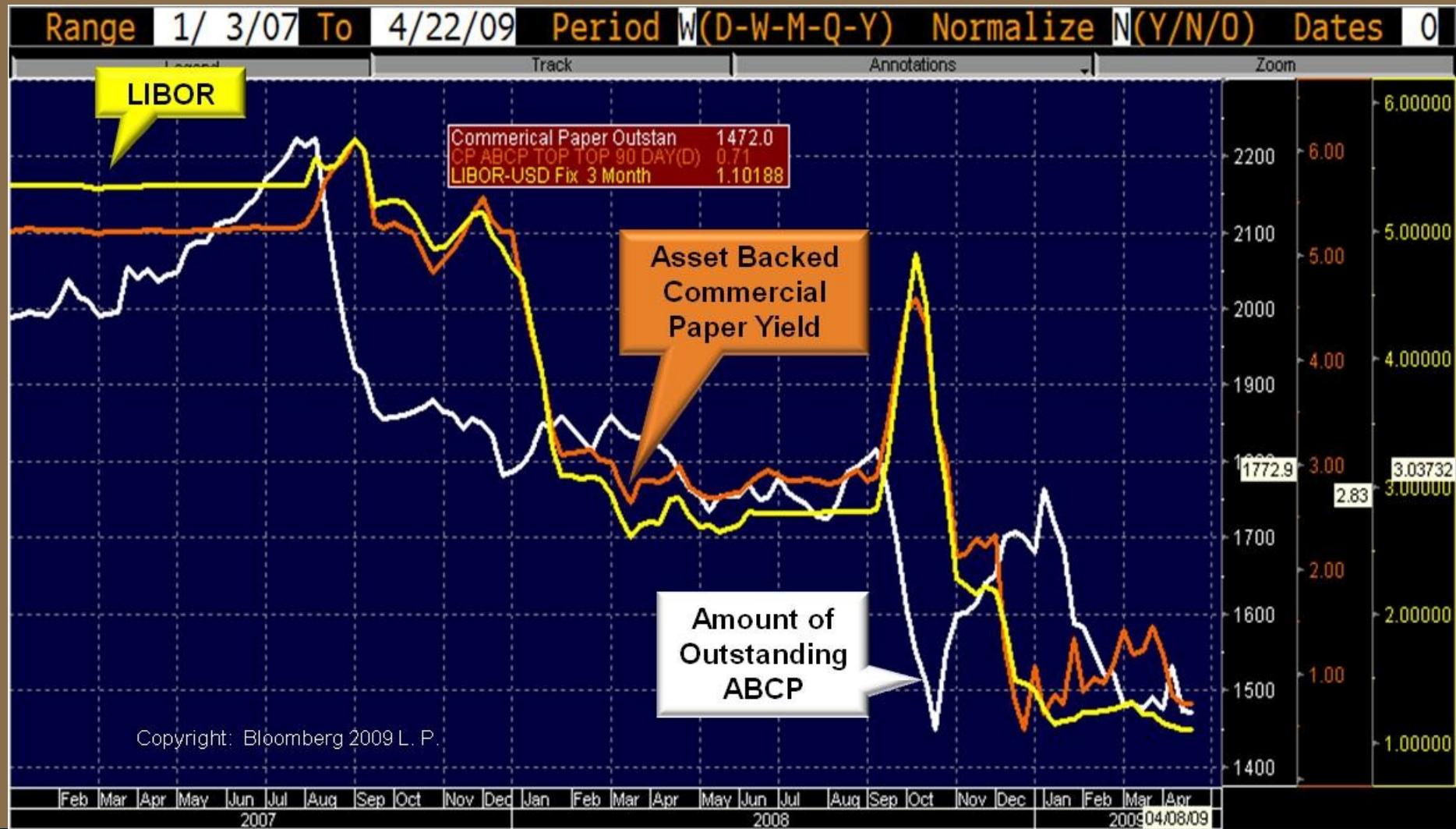
Measuring The Freeze LIBOR vs Fed Funds



Some indicators off credit stress starting to ease but still high and volatile



Asset Backed Commercial Paper issuance still down, but rates normalizing



Global Losses Up \$335 billion to \$1.3 trillion

1) Capital Raised			2) Related			3) Bailouts			4) Search			Writedowns & Credit Losses vs. Job Cuts		
Base Currency: Billions			USD			Last Update: 04/23/09 05:52:13			More Periods			6) >>		
			Total			2Q09			1Q09			4Q08		
10) All Financial			Loss	Cuts	% cut	Loss	Cuts	% cut	Loss	Cuts	% cut	Loss	Cuts	% cut
11) Worldwide			1335.2	308625	5.2	.0	19603	0.3	49.9	40024	0.7	358.1	112408	1.9
12) Americas			915.7	180657	8.1	.0	0	0	48.7	9830	0.4	242.1	75377	3.4
13) Europe			383.5	122498	3.9	.0	19553	0.6	1.2	29194	1.0	110.9	33401	1.0
14) Asia			36.1	5470	0.8	.0	50	<0.1	.0	1000	0.2	5.1	3630	0.4
15) Banks/Brokers														
16) Worldwide			961.1	295465	6.2	.0	18447	0.4	49.9	37694	0.8	252.2	109458	2.3
17) Wachovia Corporation			101.9	8393	6.9	.0	0	0	.0	0	0	49.8	0	0
18) Citigroup Inc.			101.8	38900	10.4	.0	0	0	13.7	0	0	19.7	15900	4.3
19) Bank of America Corp.			56.6	46150	22.0	.0	0	0	13.8	0	0	14.5	35000	16.7
20) Merrill Lynch & Co.			55.9	6120	9.5	.0	0	0	.0	0	0	.0	900	1.4
21) UBS AG			50.6	18740	22.4	.0	7740	9.3	.0	2000	2.4	2.0	2000	2.4
22) Washington Mutual Inc.			45.3	12000	24.3	.0	0	0	.0	2800	5.7	.0	5000	10.1
23) HSBC Holdings Plc			42.2	11998	3.7	.0	100	<0.1	.0	7300	2.3	15.6	1818	0.6
24) JPMorgan Chase & Co.			41.1	7100	3.9	.0	0	0	7.7	0	0	9.8	3000	1.7
25) Insurers														
26) Worldwide			221.2	13160	1.0	.0	1156	0.1	.0	2330	0.2	66.7	2950	0.3
27) American International Gr			87.3	980	0.8	.0	0	0	.0	0	0	23.3	380	0.3
28) Metlife Inc			12.8	0	0	.0	0	0	.0	0	0	5.6	0	0
29) Ambac Financial Group...			12.1	0	0	.0	0	0	.0	0	0	1.5	0	0
30) Hartford Financial SVCS...			11.9	500	1.6	.0	0	0	.0	0	0	5.1	500	1.6
31) Prudential Financial Inc			9.0	24	<0.1	.0	0	0	.0	24	<0.1	3.3	0	0
32) Aegon NV			7.9	0	0	.0	0	0	.0	0	0	3.2	0	0
7) Table View			8) Chart View											

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7) Table View 8) Chart View



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U.S. & Canada up \$185 billion to \$915 billion

	Total			2Q09			1Q09			4Q08		
Region	Loss	Cuts	% cut	Loss	Cuts	% cut	Loss	Cuts	% cut	Loss	Cuts	% cut
7) Worldwide	1335.2	308625	5.2	.0	19603	0.3	49.9	40024	0.7	358.1	112408	1.9
8) Americas →	915.7	180657	8.1	.0	0	0	48.7	9830	0.4	242.1	75377	3.4
9) Europe	383.5	122498	3.9	.0	19553	0.6	1.2	29194	1.0	110.9	33401	1.0
10) Asia	36.1	5470	0.8	.0	50	<0.1	.0	1000	0.2	5.1	3630	0.4

Americas Data:

Base Currency: Billions												USD
Firm	Loss↑	Cuts	% cut	Loss	Cuts	% cut	Loss	Cuts	% cut	Loss	Cuts	% cut
11) Wachovia Corporation	101.9	8393	6.9	.0	0	0	.0	0	0	49.8	0	0
12) Citigroup Inc.	101.8	38900	10.4	.0	0	0	13.7	0	0	19.7	15900	4.3
13) American Internatio...	87.3	980	0.8	.0	0	0	.0	0	0	23.3	380	0.3
14) Freddie Mac	81.6	0	0	.0	0	0	.0	0	0	22.2	0	0
15) Fannie Mae	71.3	0	0	.0	0	0	.0	0	0	17.0	0	0
16) Bank of America Corp.	56.6	46150	22.0	.0	0	0	13.8	0	0	14.5	35000	16.7
17) Merrill Lynch & Co.	55.9	6120	9.5	.0	0	0	.0	0	0	.0	900	1.4
18) Washington Mutual Inc.	45.3	12000	24.3	.0	0	0	.0	2800	5.7	.0	5000	10.1
19) JPMorgan Chase & Co.	41.1	7100	3.9	.0	0	0	7.7	0	0	9.8	3000	1.7
20) Wells Fargo & Comp...	27.9	500	0.3	.0	0	0	4.5	0	0	8.6	0	0
21) National City Corp.	25.2	4900	15.3	.0	0	0	.0	0	0	19.9	4000	12.5
22) Morgan Stanley	22.7	10993	22.8	.0	0	0	1.2	1800	3.7	5.8	4753	9.8
23) Lehman Brothers Holdi	16.2	13390	46.8	.0	0	0	.0	0	0	.0	0	0
24) Metlife Inc	12.8	0	0	.0	0	0	.0	0	0	5.6	0	0
25) Ambac Financial Gro...	12.1	0	0	.0	0	0	.0	0	0	1.5	0	0

5) Table View 6) Chart View

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What are the losses from?

1) Job Cuts

2) Search

Writedowns & Credit Losses vs. Capital Raised

Sector All Financial

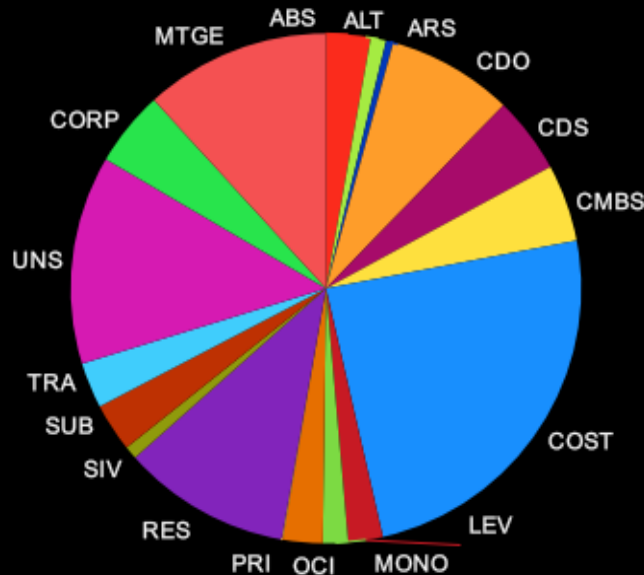
Region Americas

Option Losses by writedown type

Time Period All Quarters

Total Amount

915.71



Writedown Type	Total	%↑
COST: Credit costs/loan chargeoffs/Increased provisions	223.6	24.4
UNS : Other/unspecified/not broken down	121.1	13.2
MTGE: Other/Uncategorized Mortgages/Securities	107.7	11.8
RES : Uncategorized residential mortgage asset writedowns	97.7	10.7
CDO : Collateralilzed debt obligations	73.1	8.0
CMBS: Commercial mortgage-backed securities and real estate	44.9	4.9
CDS : Credit default swaps/other derivatives	44.4	4.9
CORP: Subsidiaries/Investments in other firms/Corporate Debt	43.8	4.8
SUB : Subprime RMBS	28.1	3.1
TRA : Trading losses	26.5	2.9
ABS : Non-mortgage Asset-backed securities	25.8	2.8
OCI : Revaluation reserve/Other comprehensive income	23.0	2.5
LEV : Leveraged loans/Collateralized Loan Obligations	20.1	2.2
MONO: Monolines	14.6	1.6
ALT : Alt-A securities	9.0	1.0
SIV : Structured Investment Vehicles/Asset-backed Commercial...	7.5	.8
ARS : Auction-rate securities	4.2	.5
PRI : Prime mortgages/securities	.6	.1

Base Currency: Billions USD

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5) Table View

6) Chart View



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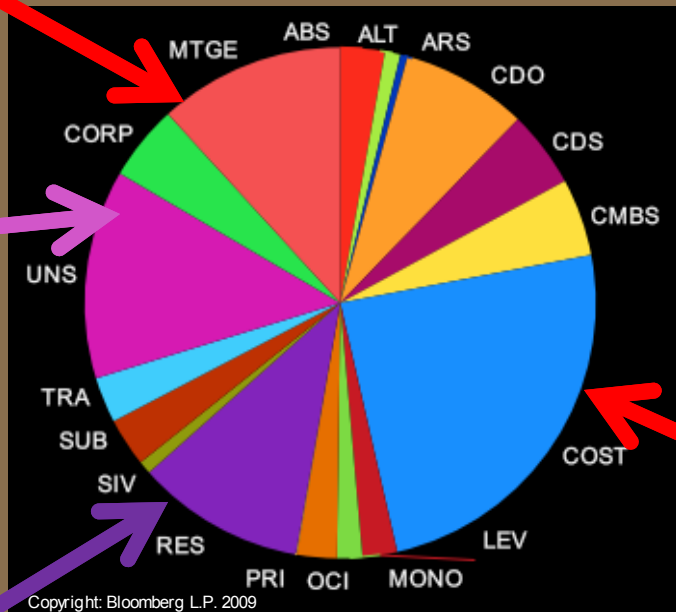
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Mortgage Securities
\$107.7 Billion

Other:
\$121.1 Billion



Credit Costs /
Loan Charge offs
\$223.6 Billion



Mortgage Asset Write-downs:
\$97.7 Billion



Interest Rate & Yield Outlook



October: Rates to be Lower

Last Calculated 10/20 16:06 EST

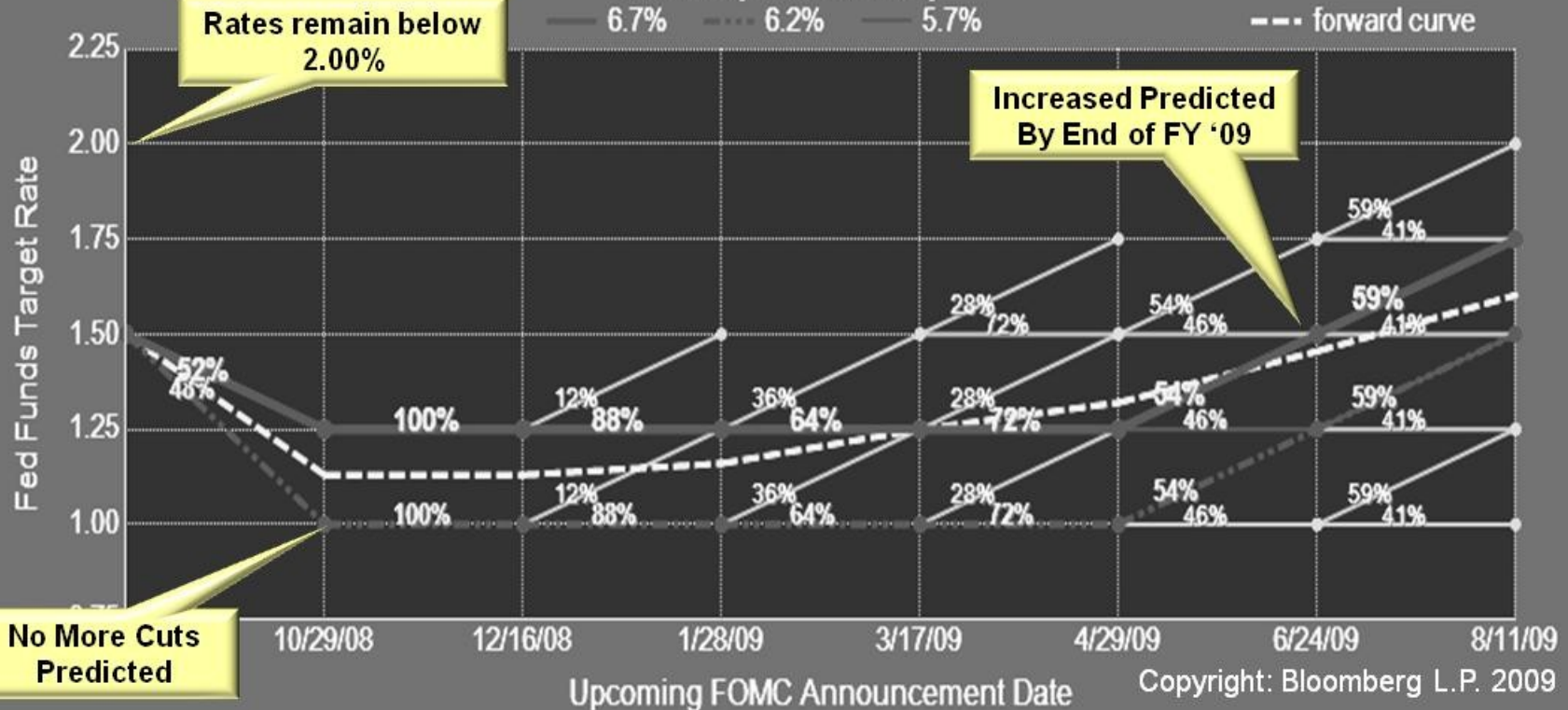
Expected Future Outcomes and Most Likely Path(s)

■ Show Peripheral Branches

Most Likely Path Probability

6.7% 6.2% 5.7%

--- forward curve



Copyright: Bloomberg L.P. 2009

Note: These scenarios were calculated using Fed Funds futures data. The most likely paths are indicated in red. The dotted yellow line represents the average expected outcome (forward curve), or the spine of the tree. Warning: The transition probabilities in the tree are estimated from potentially insufficient information about dynamics of rate changes between two FOMC meetings.

Overview

Current Implied Probability

Historical Implied Probability

Future Implied Probability



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January: Rates to remain Low in 2009

Method: ☐ Options ☒ Futures (Live) ☐ Binary Options

Last Calculated 1/23 17:40 EST

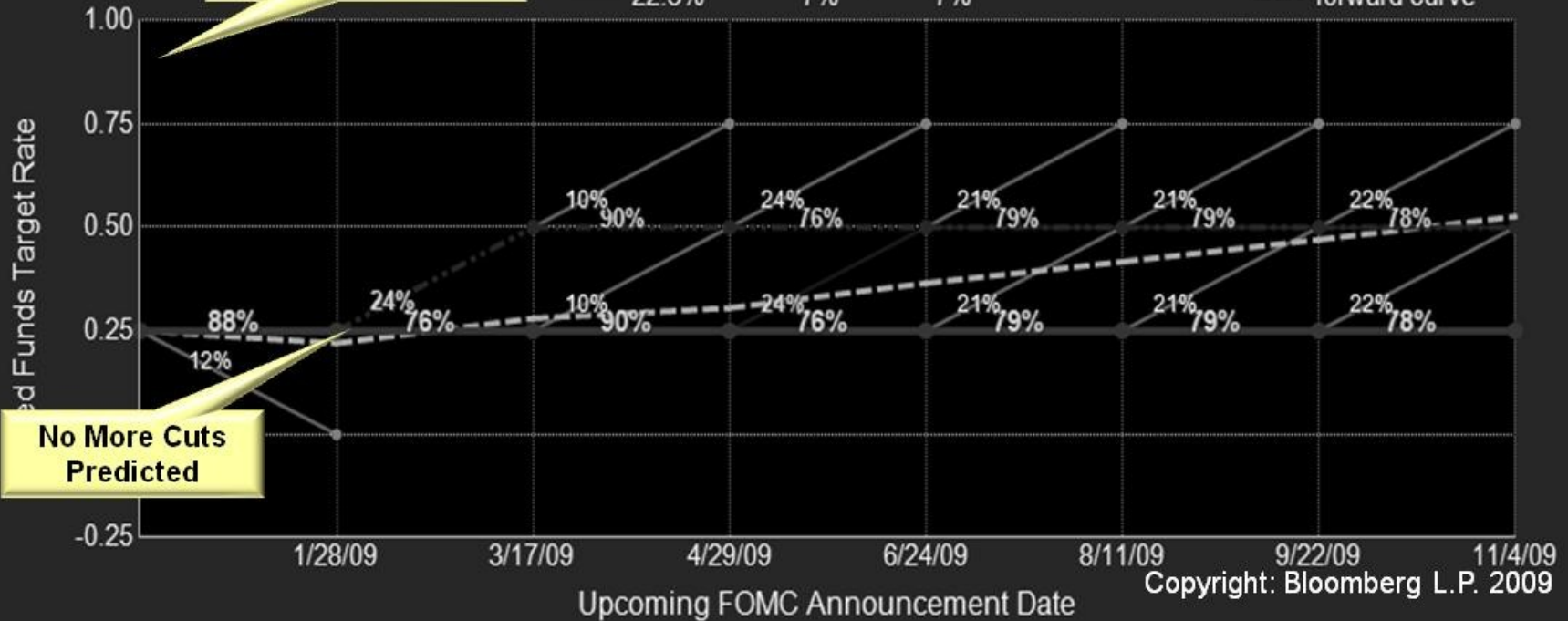
Expected Future Outcomes and Most Likely Path(s)

☒ Show Peripheral Branches

Most Likely Path Probability

22.3% 7% 7%

--- forward curve



Note: These scenarios were calculated using Fed Funds futures data. The most likely paths are indicated in red. The dotted yellow line represents the average expected outcome (forward curve), or the spine of the tree. Warning: The transition probabilities in the tree are estimated from potentially insufficient information about dynamics of rate changes between two FOMC meetings.

Overview

Current Implied Probability

Historical Implied Probability

Future Implied Probability



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April 2009: No change in outlook

Method: ● Options ● Futures (Live) ● Binary Options

Last Calculated 4/24 12:56 NY

Expected Future Outcomes and Most Likely Path(s)

■ Show Peripheral Branches

Most Likely Path Probability

— 36.8% - - - 11.6% — 8.6%

- - - forward curve



Note: These scenarios were calculated using Fed Funds futures data. The most likely paths are indicated in red. The dotted yellow line represents the average expected outcome (forward curve), or the spine of the tree. Warning: The transition probabilities in the tree are estimated from potentially insufficient information about dynamics of rate changes between two FOMC meetings.

Overview

Current Implied Probability

Historical Implied Probability

Future Implied Probability



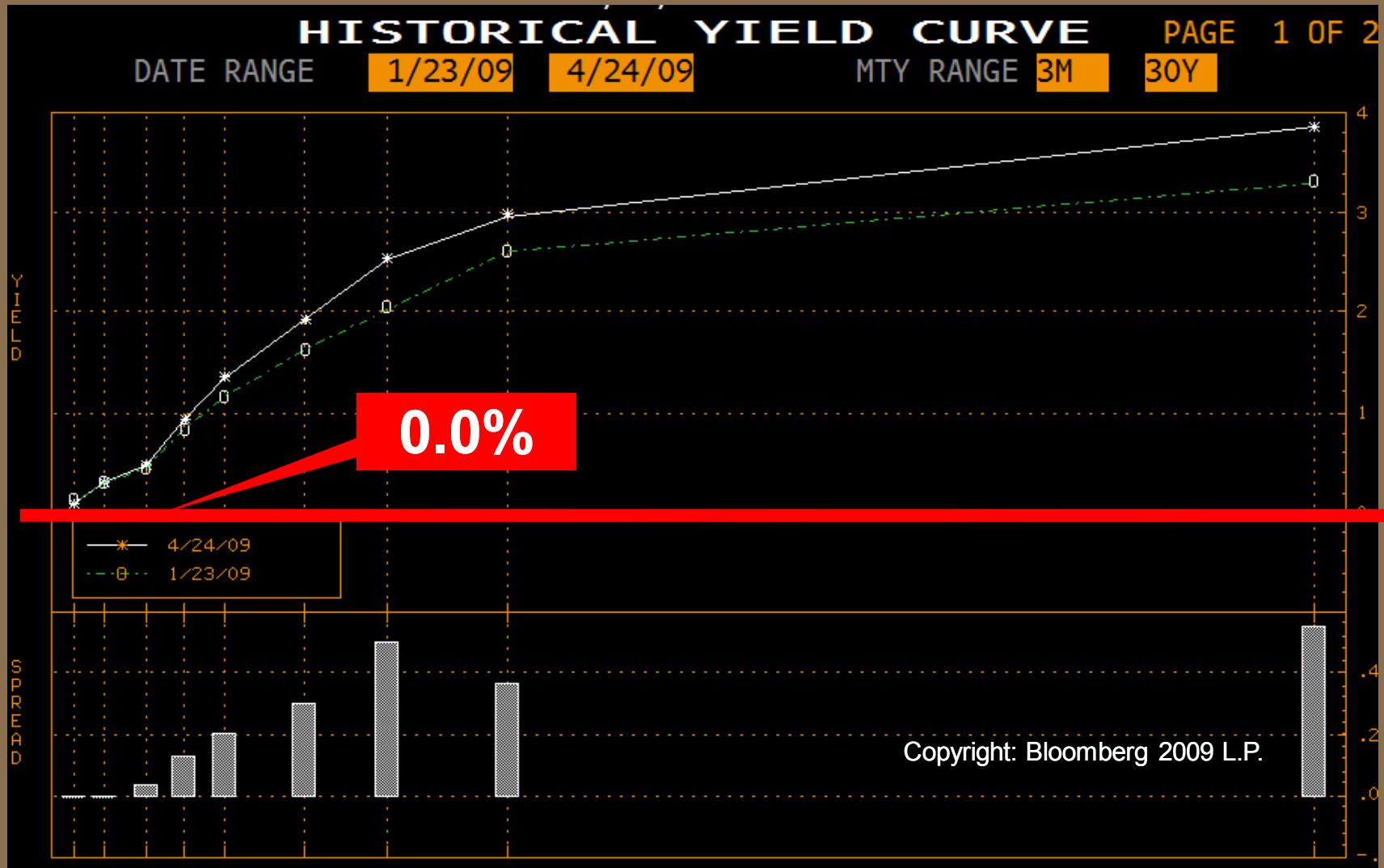
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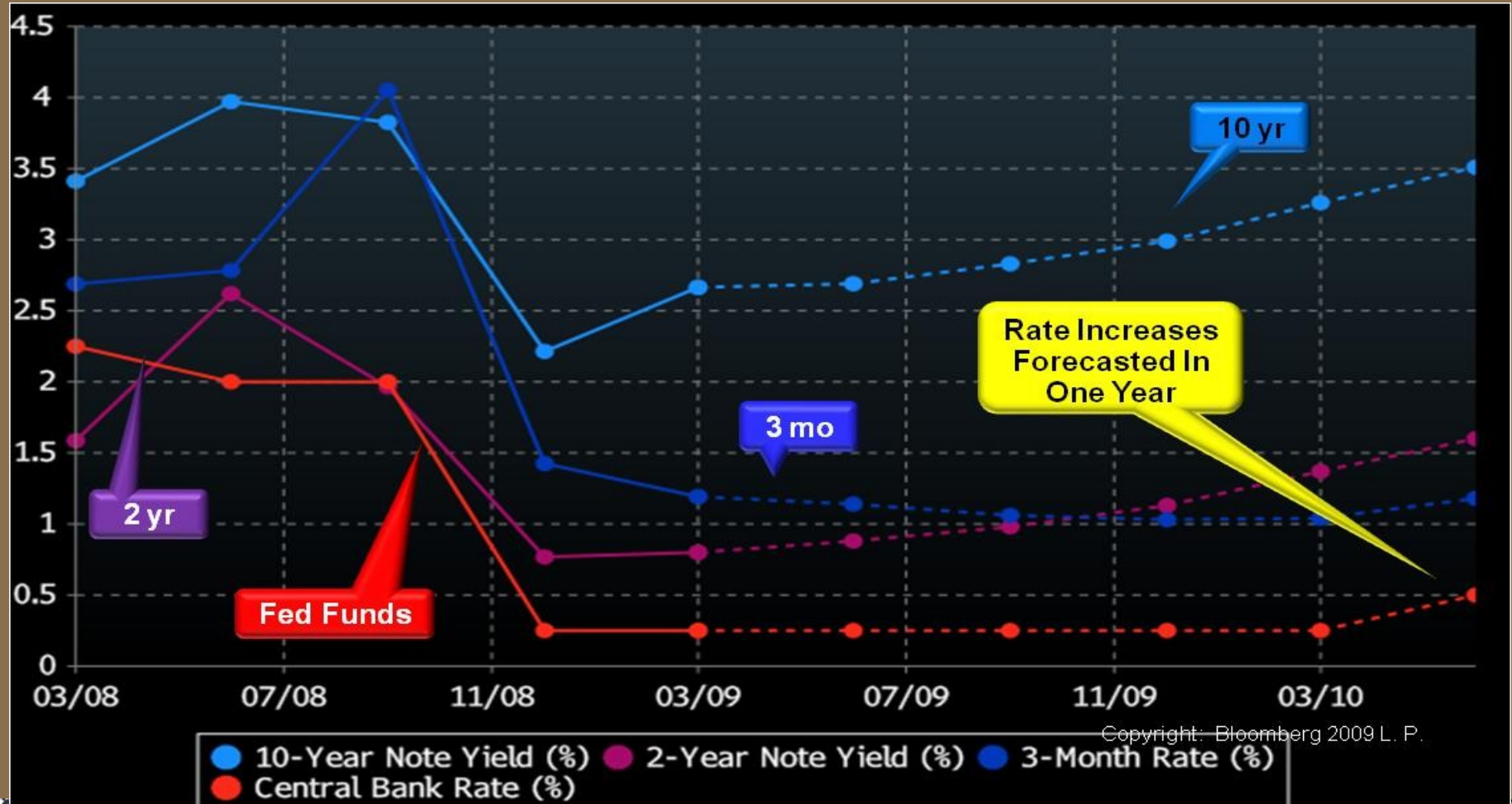


Yield Curve Rising on Long End



Short Term Interest Rate Forecast: Steady and Low

Composite Survey of 80+ Economists



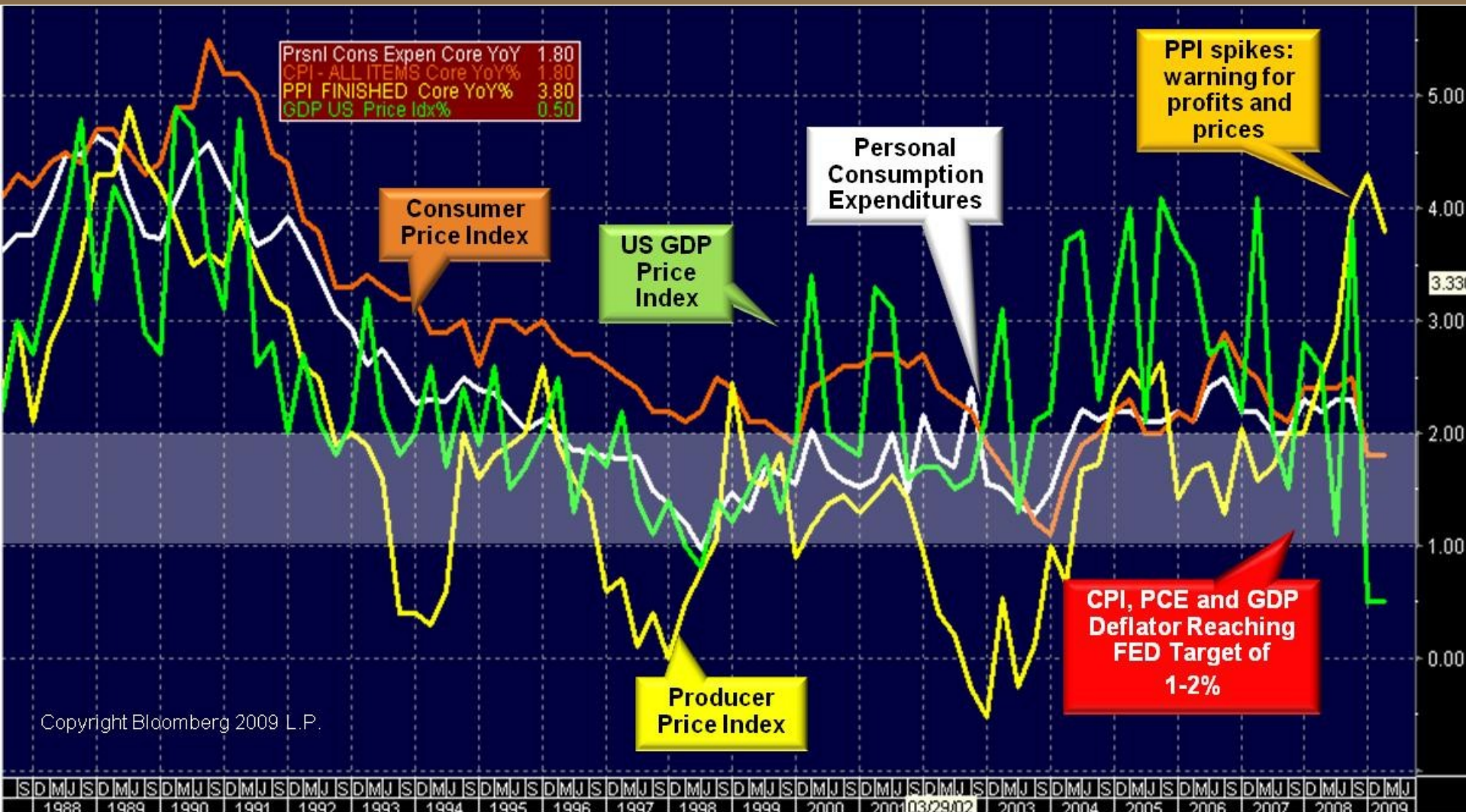
Market Reaction to Rate Cuts

US Treasury Yields vs. Fed Funds (last 360 days)



Inflation

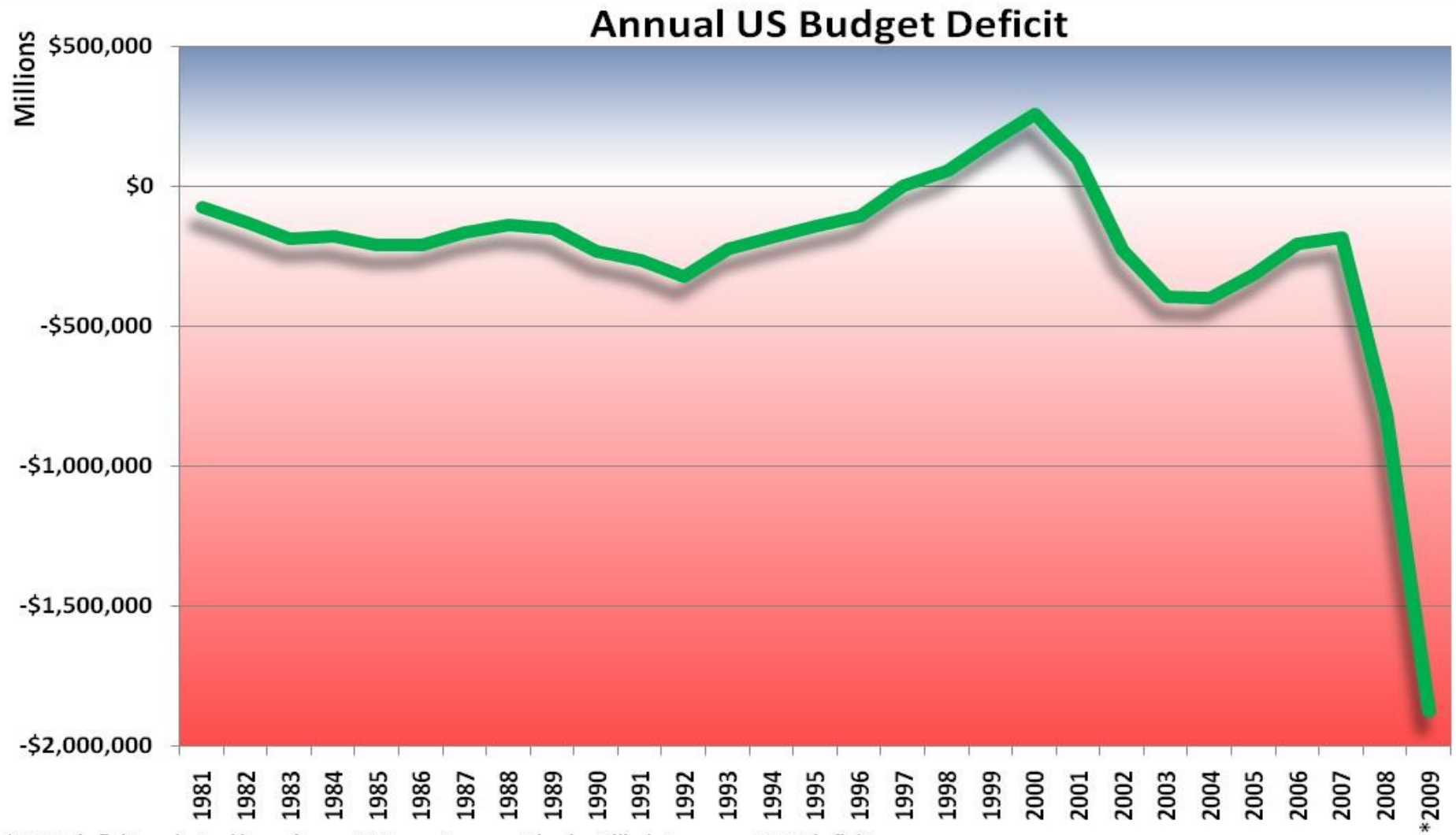
PCE, PPI, CPI CORE, and GDP RATES Quarterly since 1987



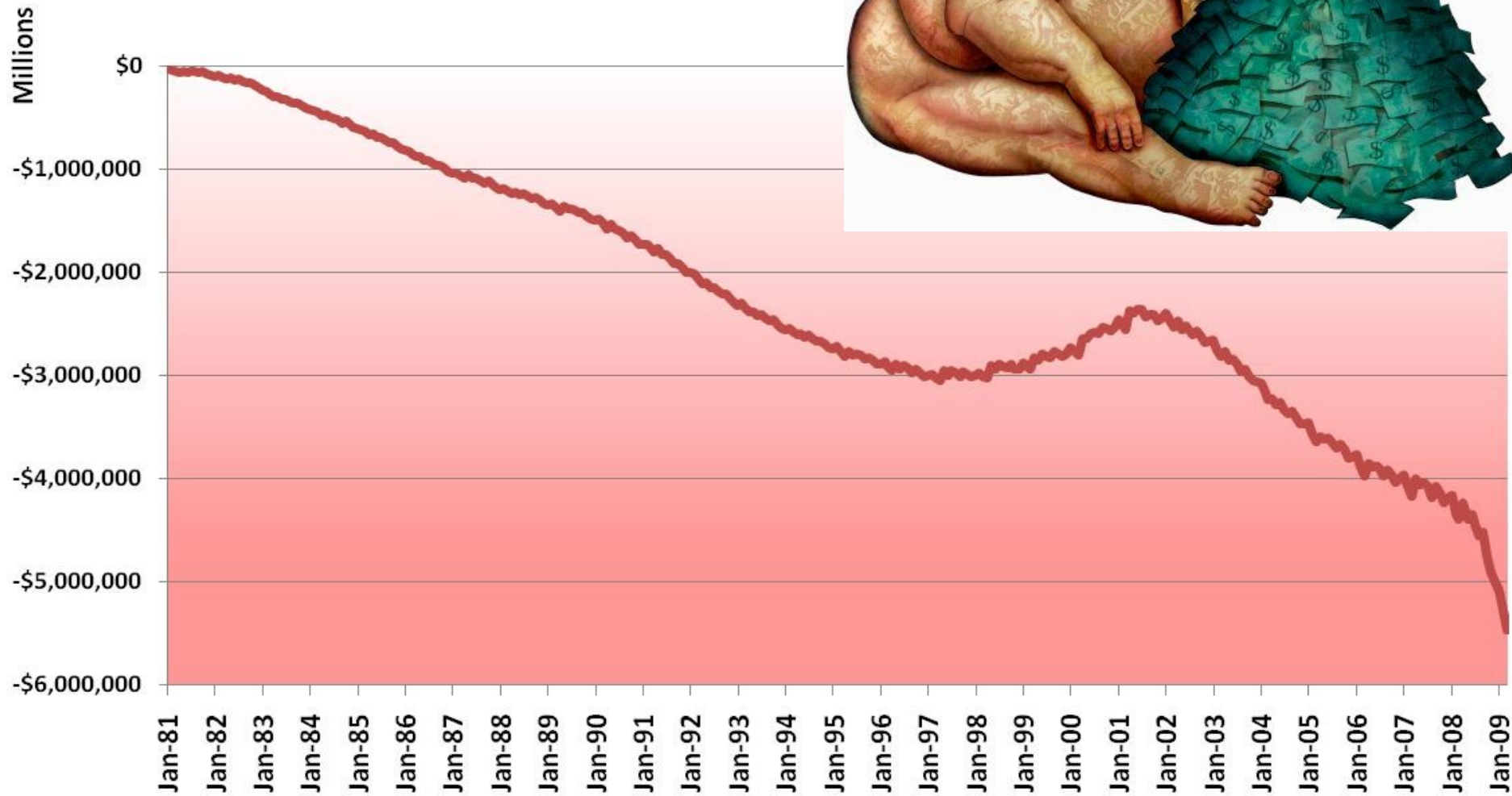
Is High Spending Going To Impact Inflation?



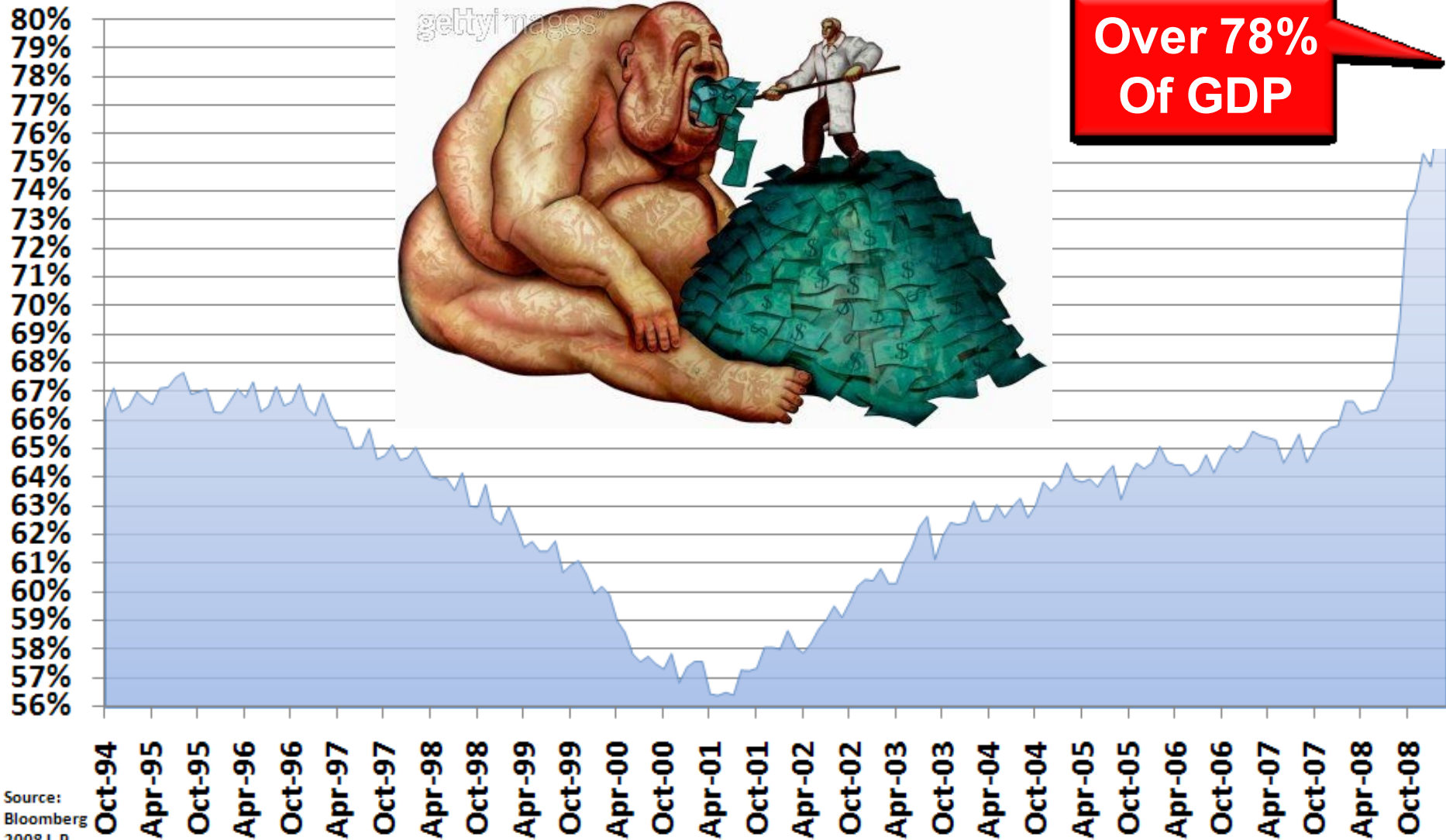
Annual US Budget Surplus / Deficit



Cumulative Total US Debt since 1981



Federal Debt as % of GDP is Soaring



Economic Forecast



The Economic Cycle

**The
Bubble
Bursts**

**The
Crash
Phase**

**The
1st
Turn**

**Hit
Bottom**

**The
Recovery
Begins**



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The National Economy & Financial Markets

1st
Crash
Phase

1st Turn
April 2008

End of
2011

The
Housing
Bubble
Bursts

Zero
Growth

New Crash
Phase
Sept. 2008

End of
2010

Hit
Bottom
4th Qtr.
2009



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The Arizona Economy

The
Housing
Bubble
Bursts

Zero
Growth

The
Crash
Phase

1st Turn
1st / 2nd
Qtr. 2009

Hit
Bottom
End
2009

End of
2010

End of
2011

End of
2012



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Arizona Housing lags National Housing Market

The
Bubble
Bursts

Where
we are
now

1st Turn
Late
1st Qtr
'09

Hit
Bottom
4th Qtr.
2009

End of
2010

End of
2011

End of
2012

End of
2013

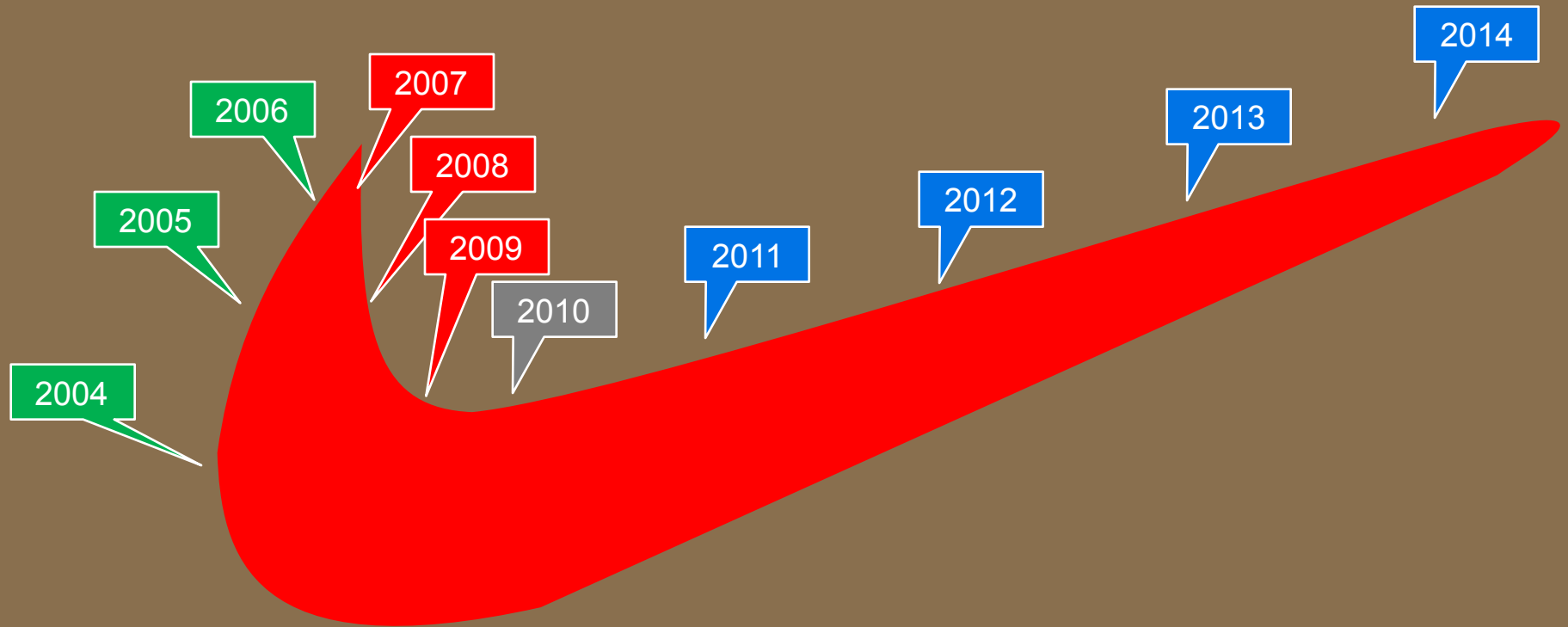
End of
2014



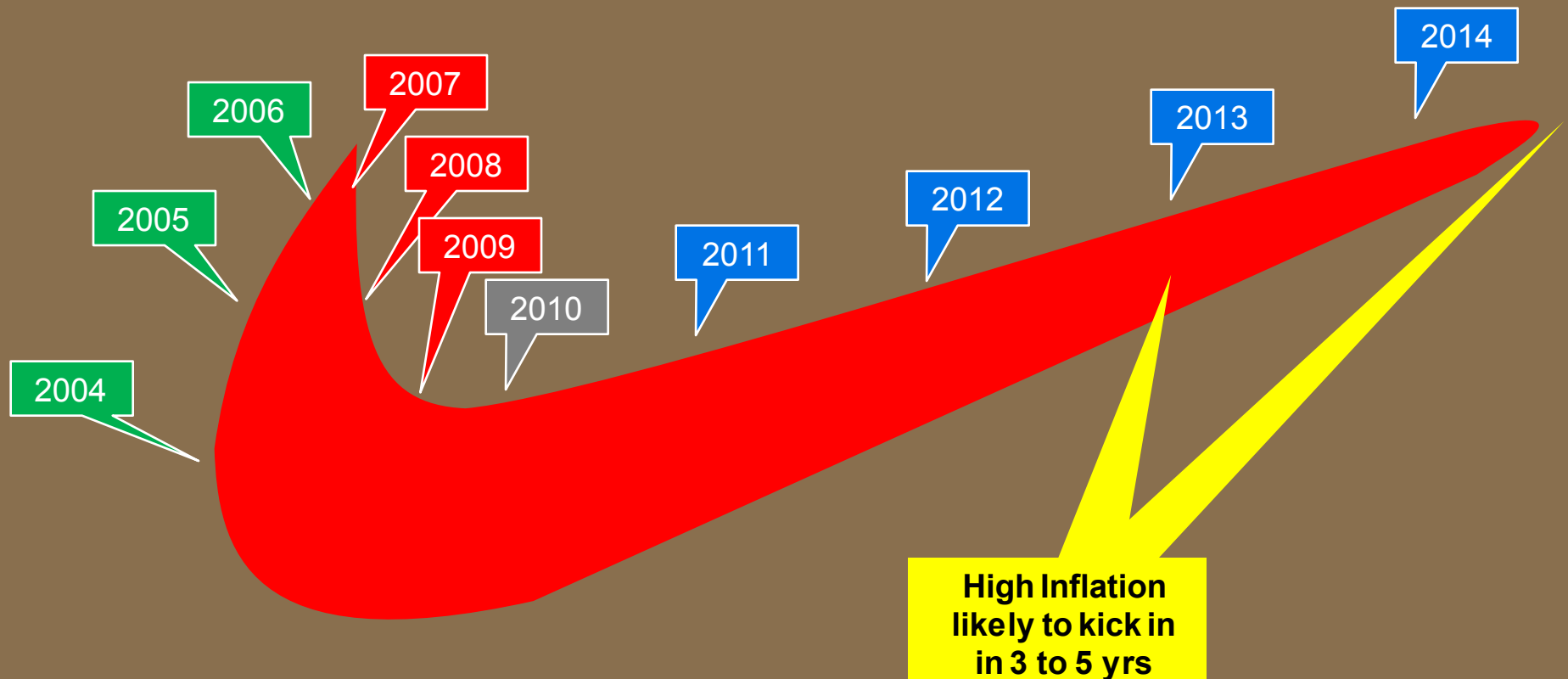
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“Nike” Whoosh Forecast



“Nike” Whoosh Forecast



Swine Flu going to prolong the US recession?

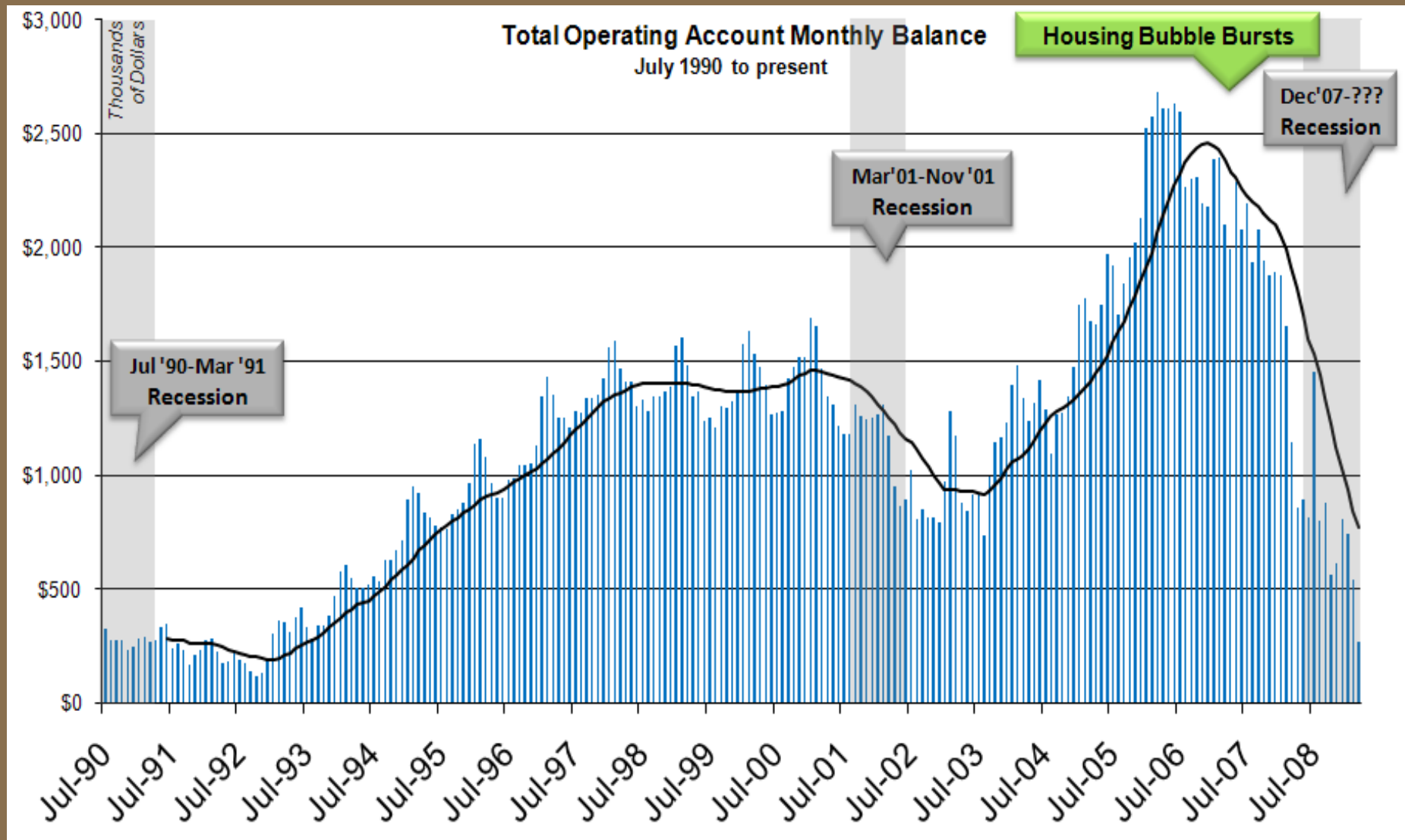


State Budget Update



State Total Operating Account Average Monthly Balance

July 1990 to present



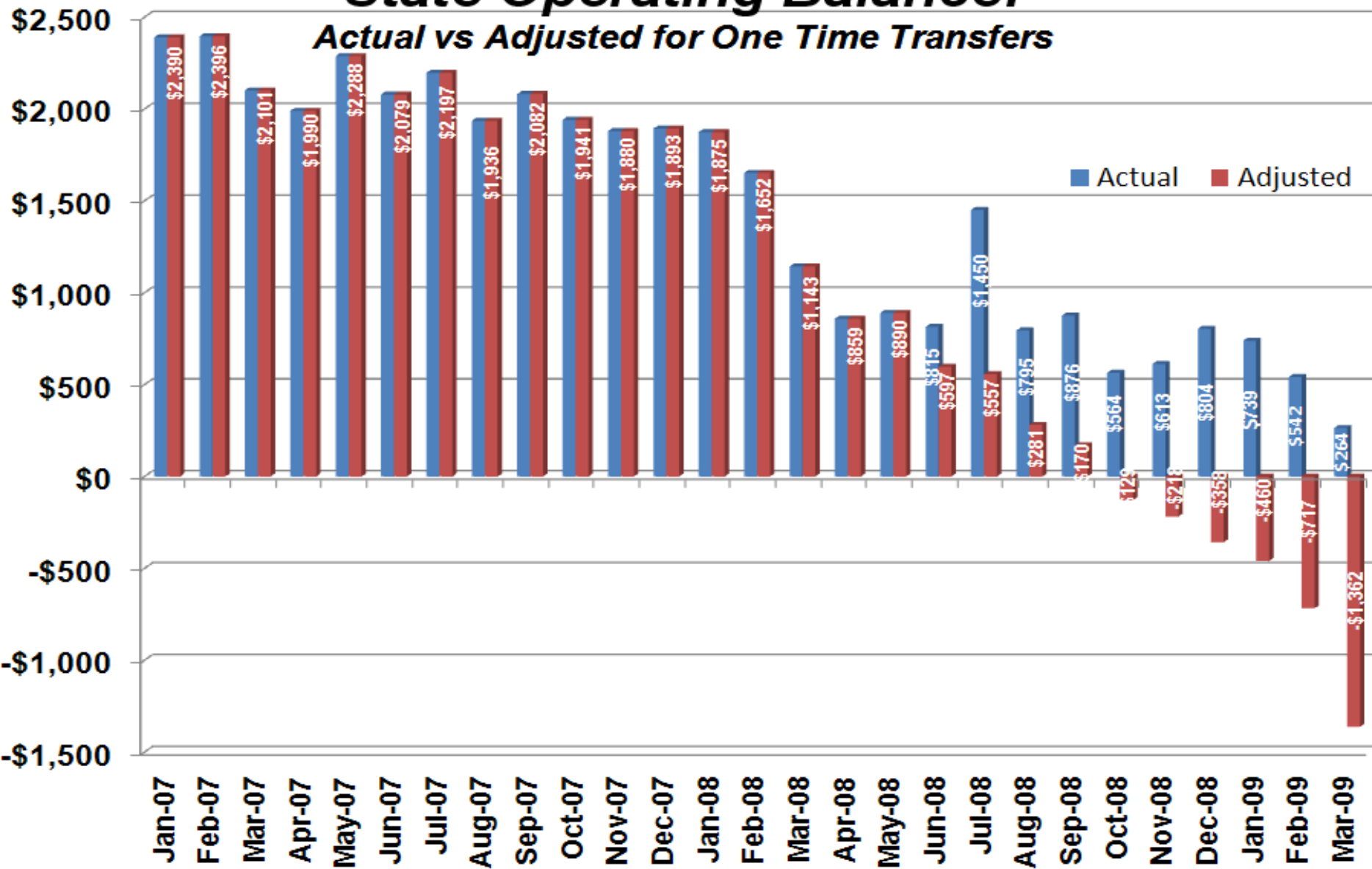
State of Arizona Operating Cash Balance On A Downward Trend

Percent Change in Operating Account Balance



State Operating Balance:

Actual vs Adjusted for One Time Transfers



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State Operating Fund Ran Out Of Cash In April as forecasted



- Short \$340 million on April 15th
- Operating Fund in the Red until April 28th
- Average daily shortfall \$198 million



How did we keep the lights on?

Where did the money come From?



Where did the money come From?



- State Agencies Diversified Pool 3.
- Has about \$1.4 billion in assets.
- Consists of non-general fund state agency funds allowed to earn interest.
- Purchased Treasurer's Warrant Notes rather than Treasuries, Agencies, or Repo.

**We Will Not Tap Any LGIP Funds
For State Borrowing.**



LGIP Performance

3rd Quarter and FY 2009 YTD



S & P Rating of Pool 5

AAAf / S1

We Continue
To Maintain
The Highest
Rating From
S & P



S1

S2

S3

S4

S5

S6

AAAf

AA+f

AAf

AA-f

A+f

Af

A-f

BBB+f

BBBf

BBB-f

BB+f

BBf

BB-f

B+f

Bf

B-f

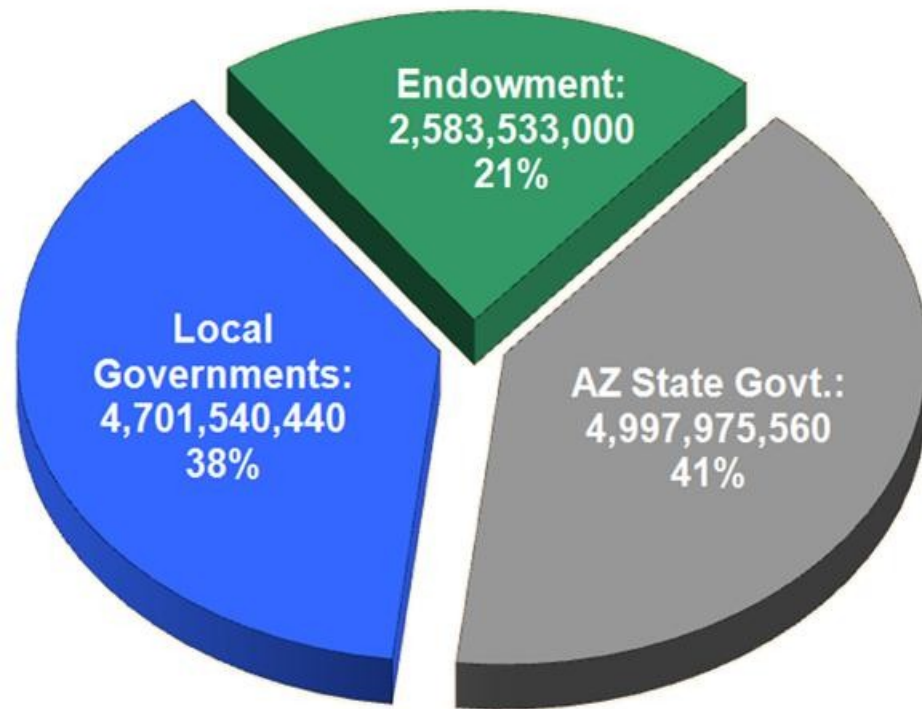
CCC+f

CCCf

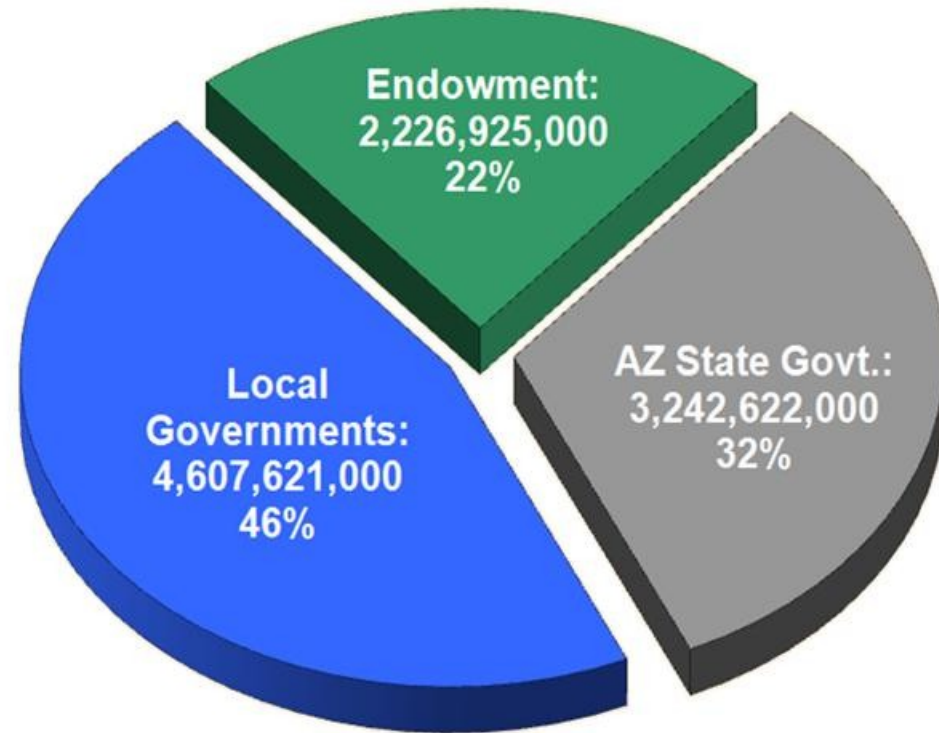


Assets Under Management (market value)

March 2008



March 2009



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FY 09 Performance

Operating Revenue to the State of Arizona
State Agencies, Endowment and LGIP Clients

YTD FY 2009 Earnings Distributed:

\$174,590,576

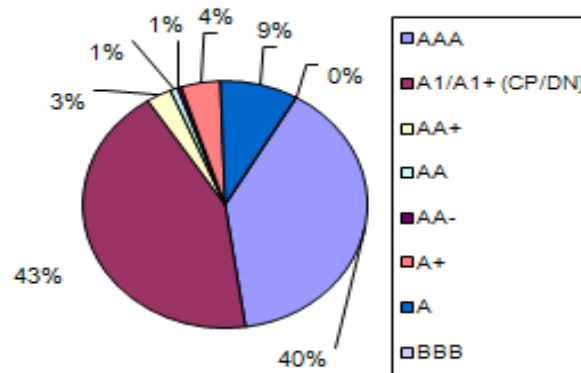
(\$10.9 million for general fund)
(\$52.3 million for the Endowment)
(\$42.8 million for Local Govt.'s)



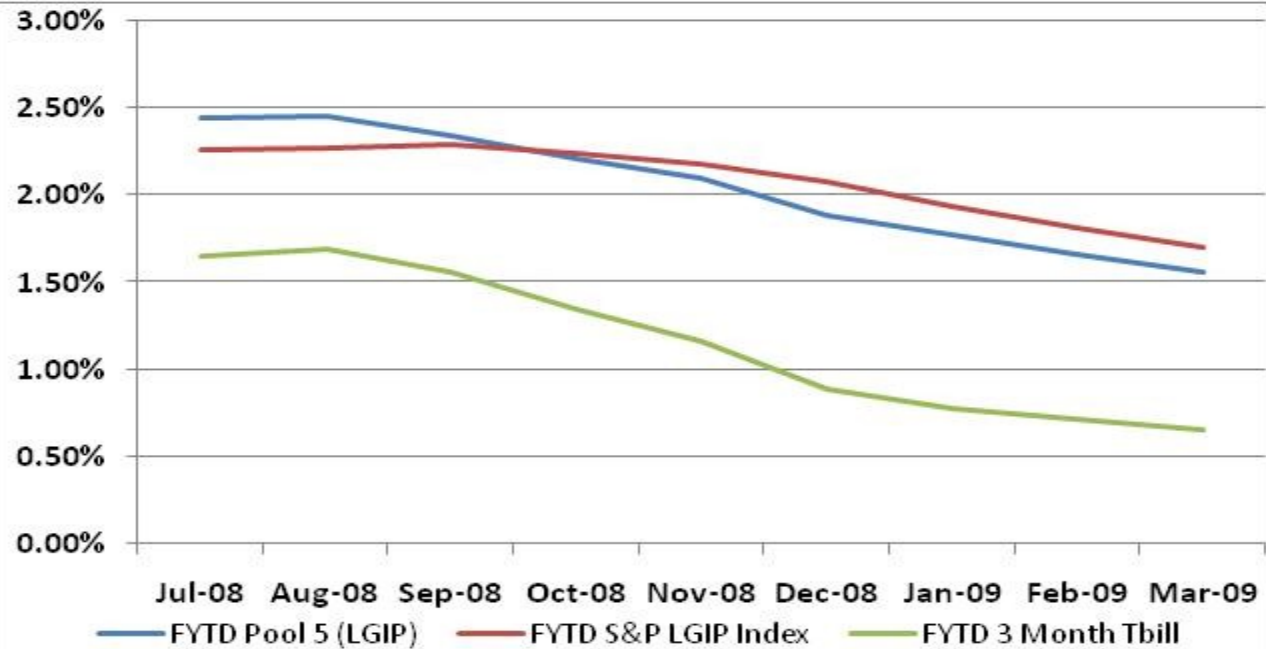
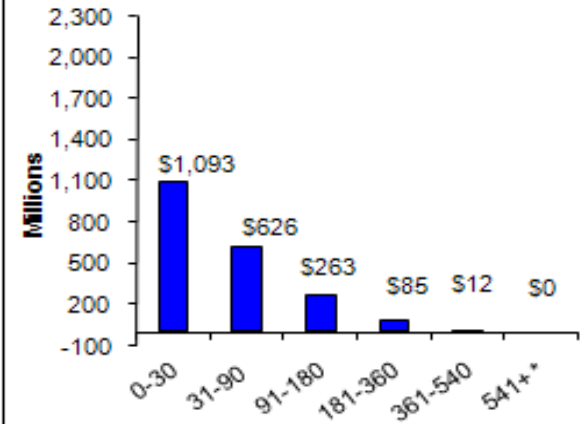
LGIP – Pool 5

- Fixed Income
- Short Term
- \$2.08 Billion as of 3/31/09
- WAM – 53.5 days* (weighted average maturity)
- NAV - .997 (Net Asset Value)

3/31/09 MARKET VALUE BY RATING PERCENTAGE



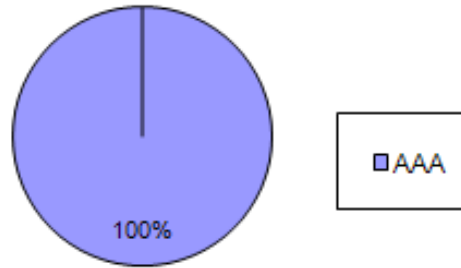
3/31/09 MARKET VALUE BY MATURITY



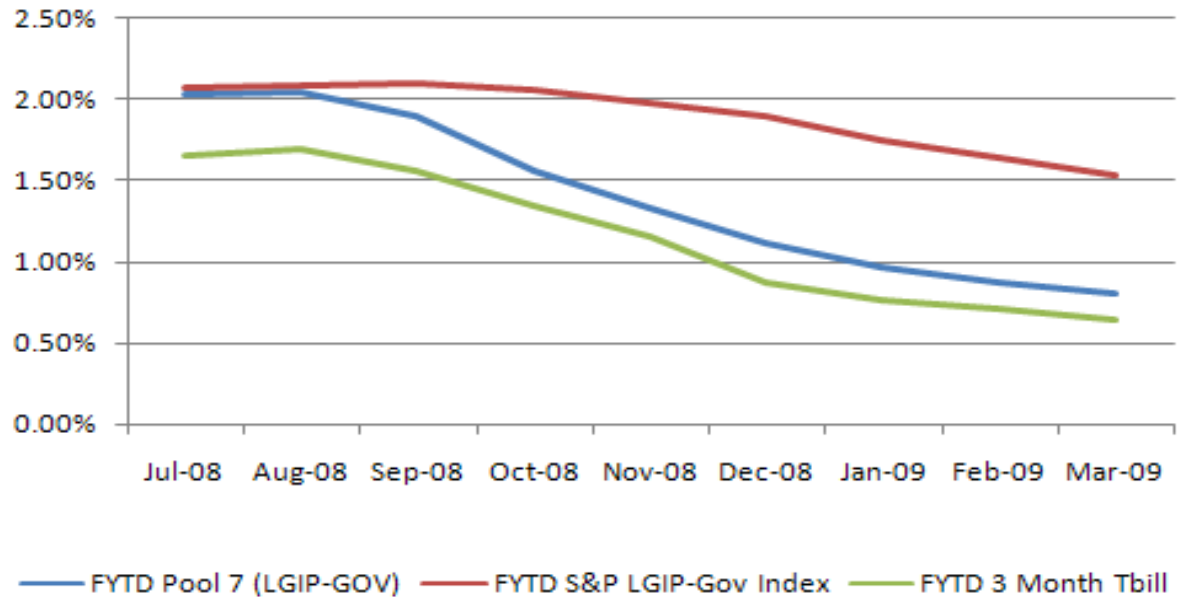
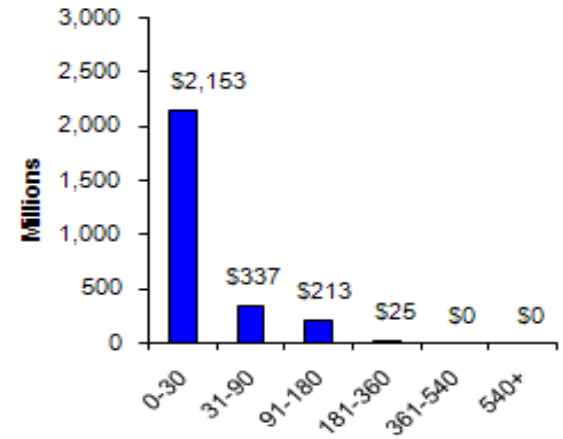
LGIP – Pool 7

- Fixed Income
- Full Faith & Credit (Backed by US Treasuries Only)
- Short Term
- \$2.73 Billion as of 3/31/09
- WAM – 21.69 days (weighted average maturity)
- NAV - \$1.00 (Net Asset Value)

3/31/09 MARKET VALUE BY RATING PERCENTAGE

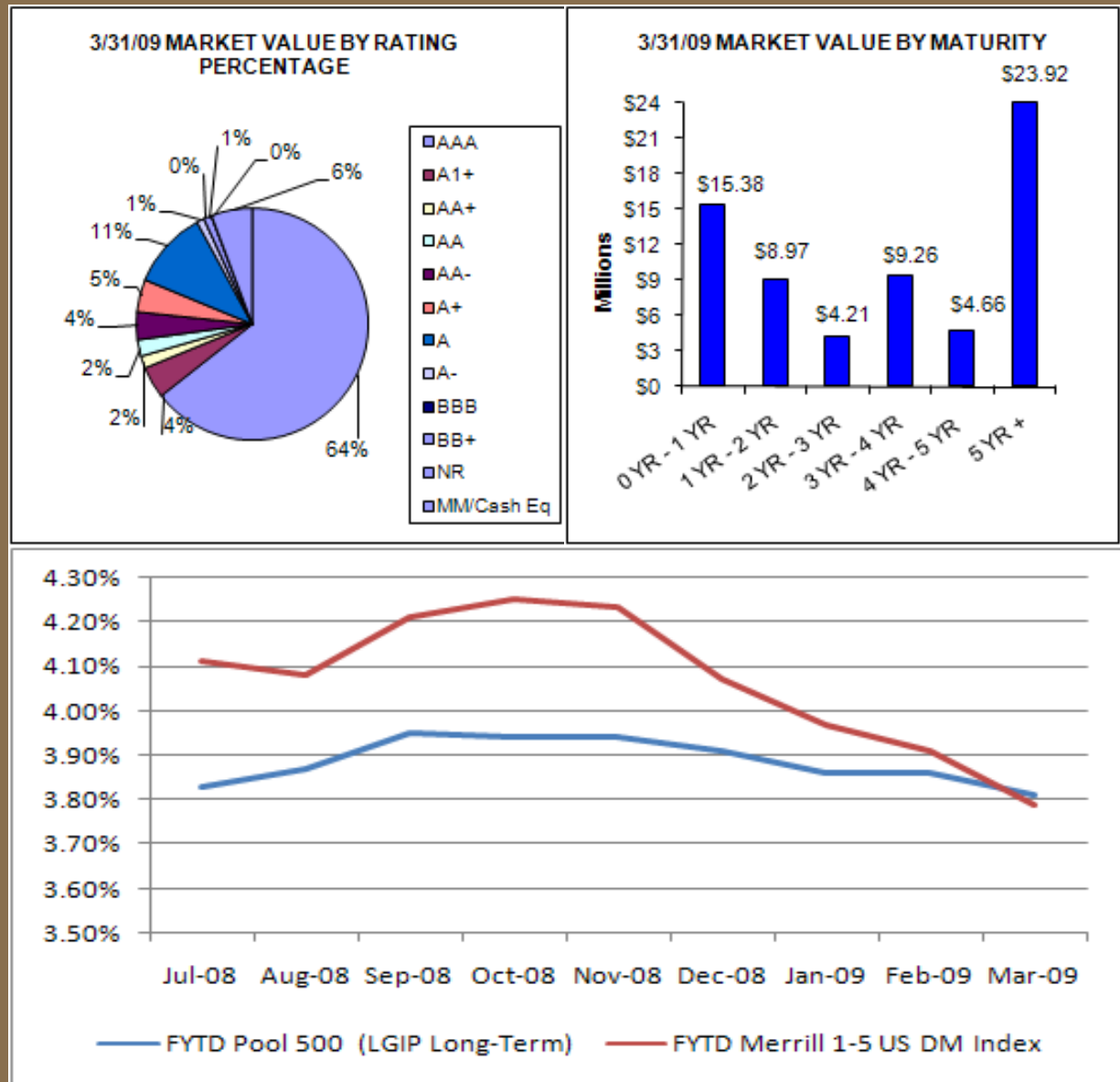


3/31/09 MARKET VALUE BY MATURITY



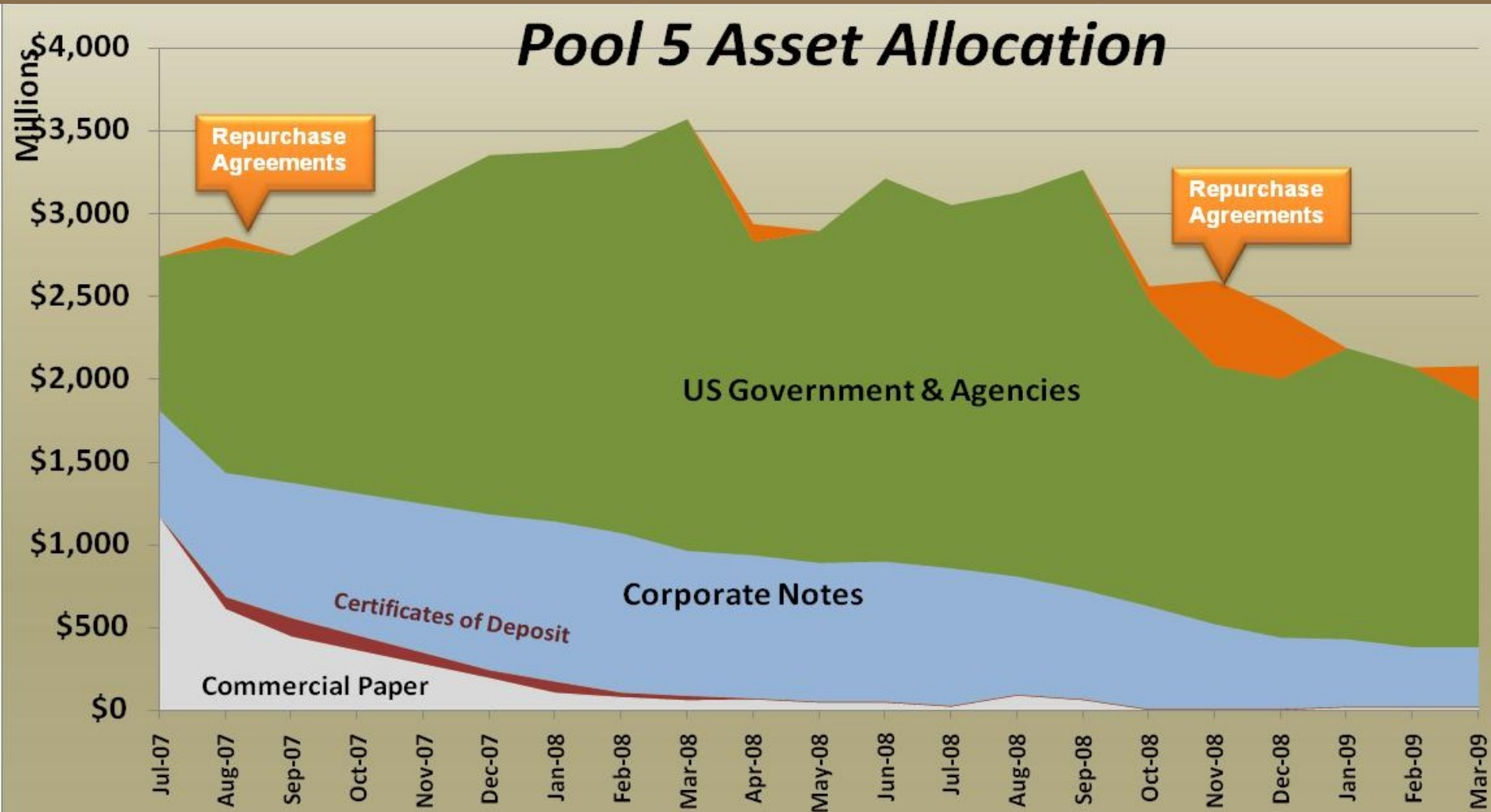
LGIP – Pool 500

- Fixed Income
- Long Term
- \$66.83 Million as of 3/31/09
- Duration 1.22 years
- Floating NAV (Net Asset Value)



Responding to Credit Crunch:

Increased Allocation to UST and US Govt. Agency Discount Notes



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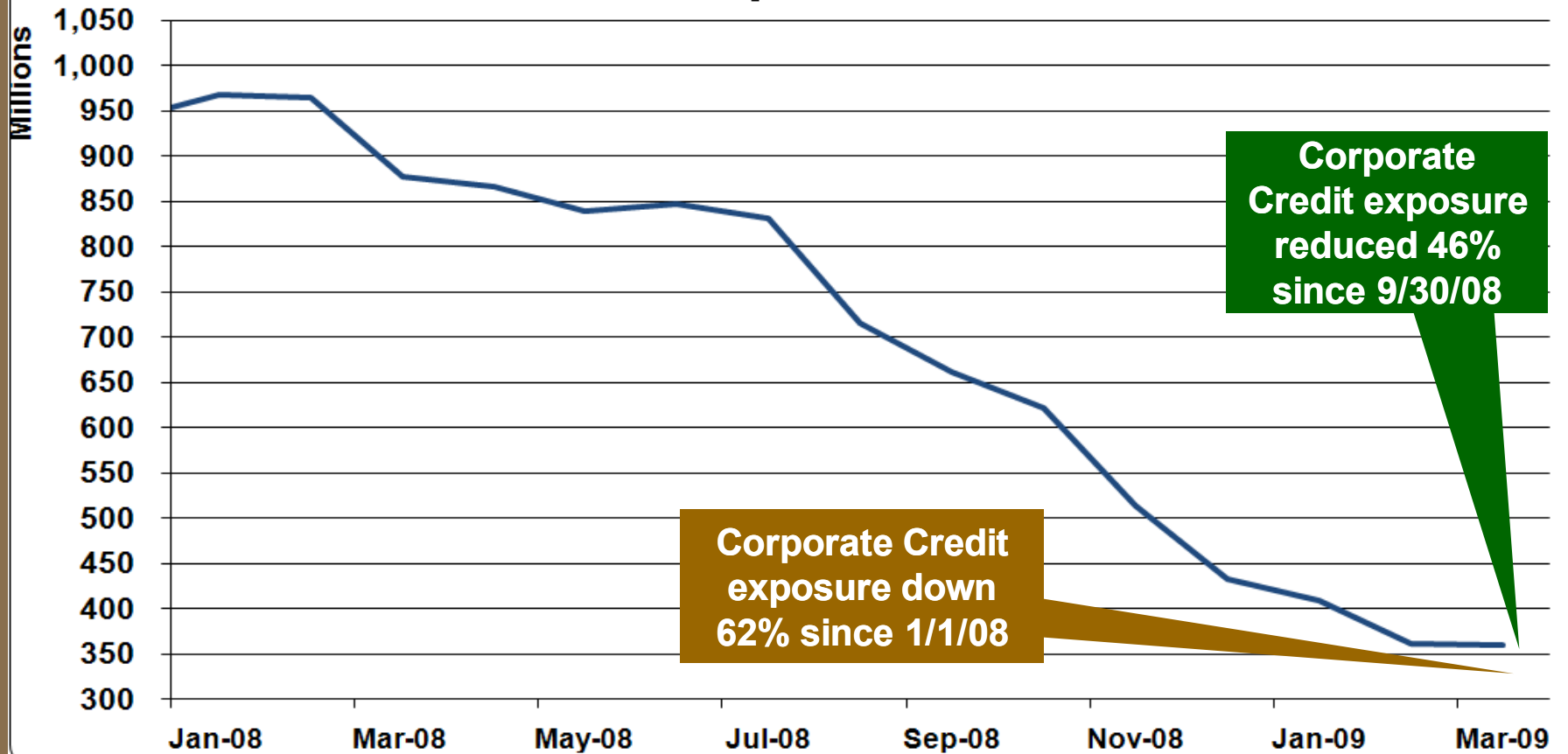
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Responding to Credit Crunch: Reduction in Corporate Exposure

Pool 5 Corporate Notes



Responding to Credit Crunch:

Reduction in Corporate Exposure since Sept. '08

Holdings Reduced:

American Express – 53%

American Honda – 66%

ATT – 31%

Caterpillar – 75%

GE Capital – 36%

HP – 20%

John Deere – 50%

Merrill Lynch – 46.3%

Target – 22%

Wells Fargo – 41%

Holdings Eliminated:

Citigroup

Morgan Stanley

Toyota Motor Credit

UBS

National Rural Utilities

Wal Mart

IBM

Textron

Further Reductions by 6/12/09:

American Express – 74%

American Honda – 100%

Merrill Lynch – 77.2%



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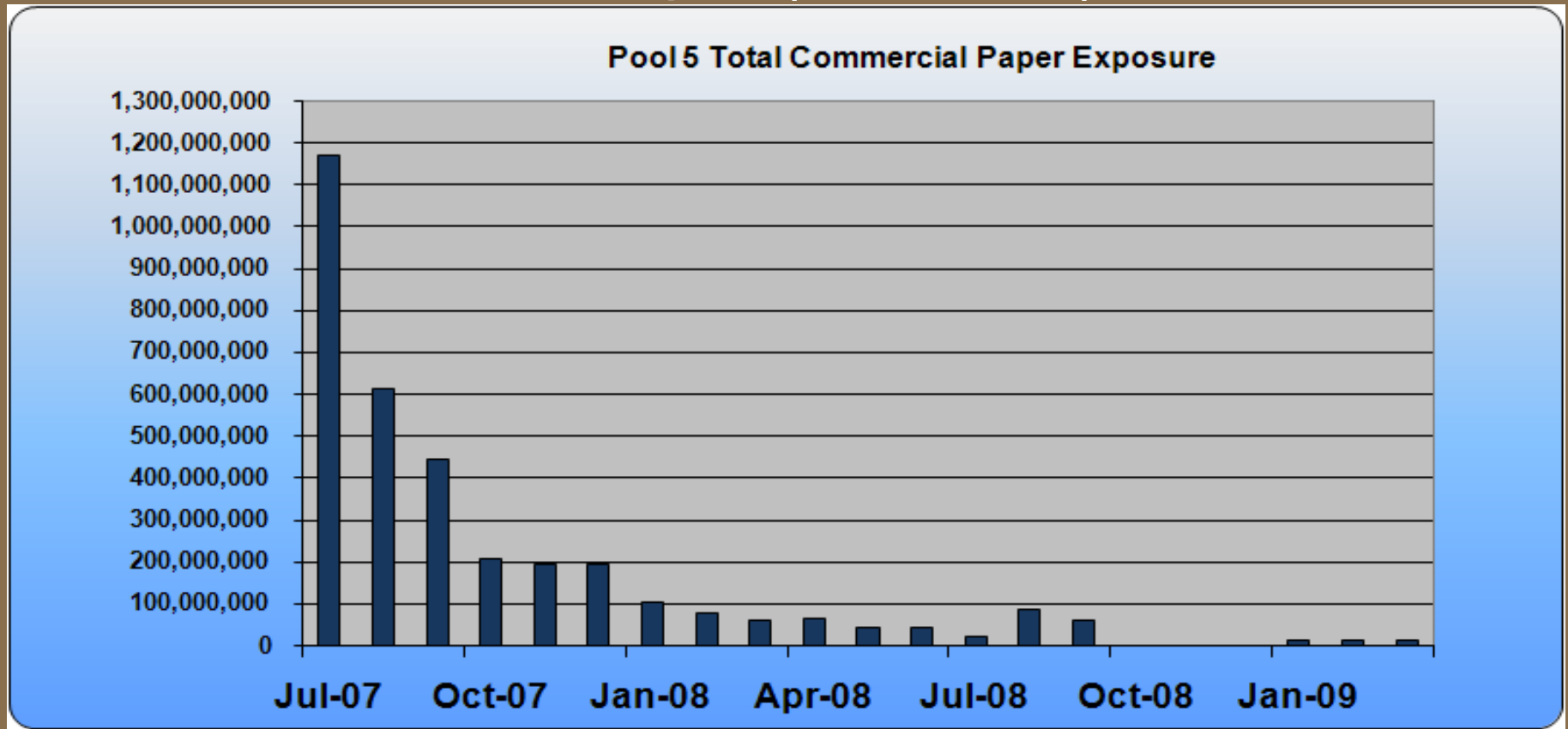
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Responding to Credit Crunch:

Reduction in Commercial Paper and Asset Backed Commercial Paper (CP/ABCP) in Pool 5



Risk Management Improvements

- Restructuring Pool 5 so each non-government credit is no more than 0.5% of pool assets (approximately \$15 million).
- Added Independent Credit Review Company *Gimmie Credit* to assist with credit analyst work along with *Moody's*.
- Investment Risk Management committee consisting of Treasurer, Deputy Treasurer, Portfolio Managers continues to meet weekly to review credits in all investment pools.
- Adopted policy to not buy anything for Pool 5 that is not listed as stable or improving for either Corporate Debt, Commercial Paper or ABCP.
- Committee structure diversifies risk management input, and strengthens existing risk management procedures.



Other Improvements

- New Custodian Bank April 1st.
- Accounting transition to take place July 1.
- Statements should be available sooner starting in August/September.
- Better on-line access to accounts.
- Securities Lending to cover cost of contract as well as possibly provide additional revenue to investment pools.





2009 Legislative Agenda



2009 Legislative Agenda

- HB 2104: Quarterly meetings by the Treasurer's office made a statutory requirement for all future Treasurer's.
- HB2271: Moves mid-term Pools 500 and 700 from Title 41 to Title 35 and allows State Funds to participate in mid-term pools.
- HB2425: Lowers the maximum management fee from 12 to 6 basis points (currently 6 basis points). Allows operations of office to be paid for from management fees.
- SB1150: Adds a third public member to Board of Investment with emphasis on Endowment.
- HB2103: Allows office to hire legal counsel.



Endowment Performance

3rd Quarter FY 2009

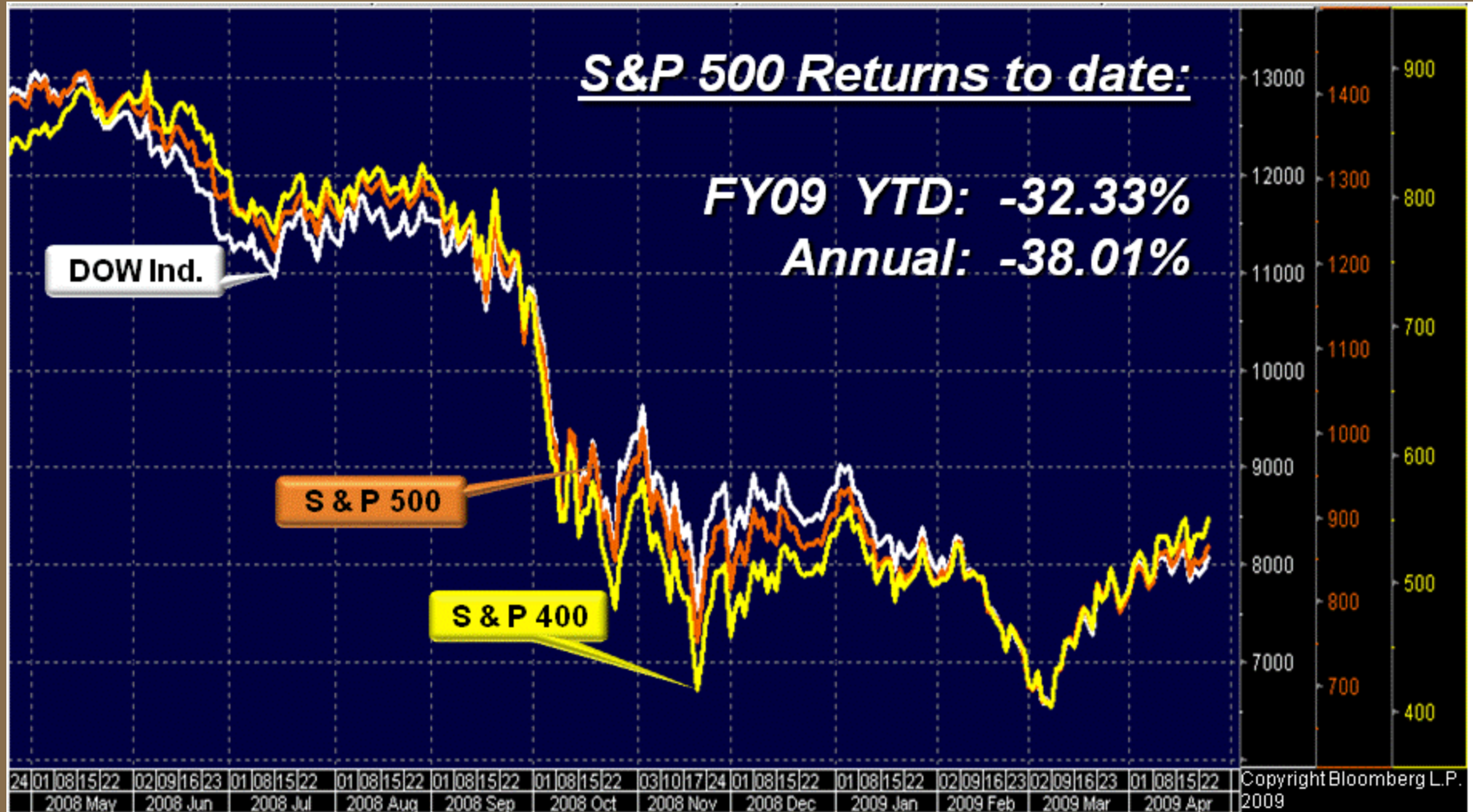


Are The Bears Taking A Nap?



US Stock Markets

DOW, S&P 500, S&P 400



Or has the recent rally been a...



DEAD CAT
BOUNCE

A **dead cat bounce** is a figurative term used by traders in the finance industry to describe a pattern wherein a spectacular decline is followed by a moderate and temporary rise before resuming its downward movement, with the connotation that the rise was not an indication of improving circumstances in the fundamentals of the stock. It is derived from the notion that ***"even a dead cat will bounce if it falls from a great height".***



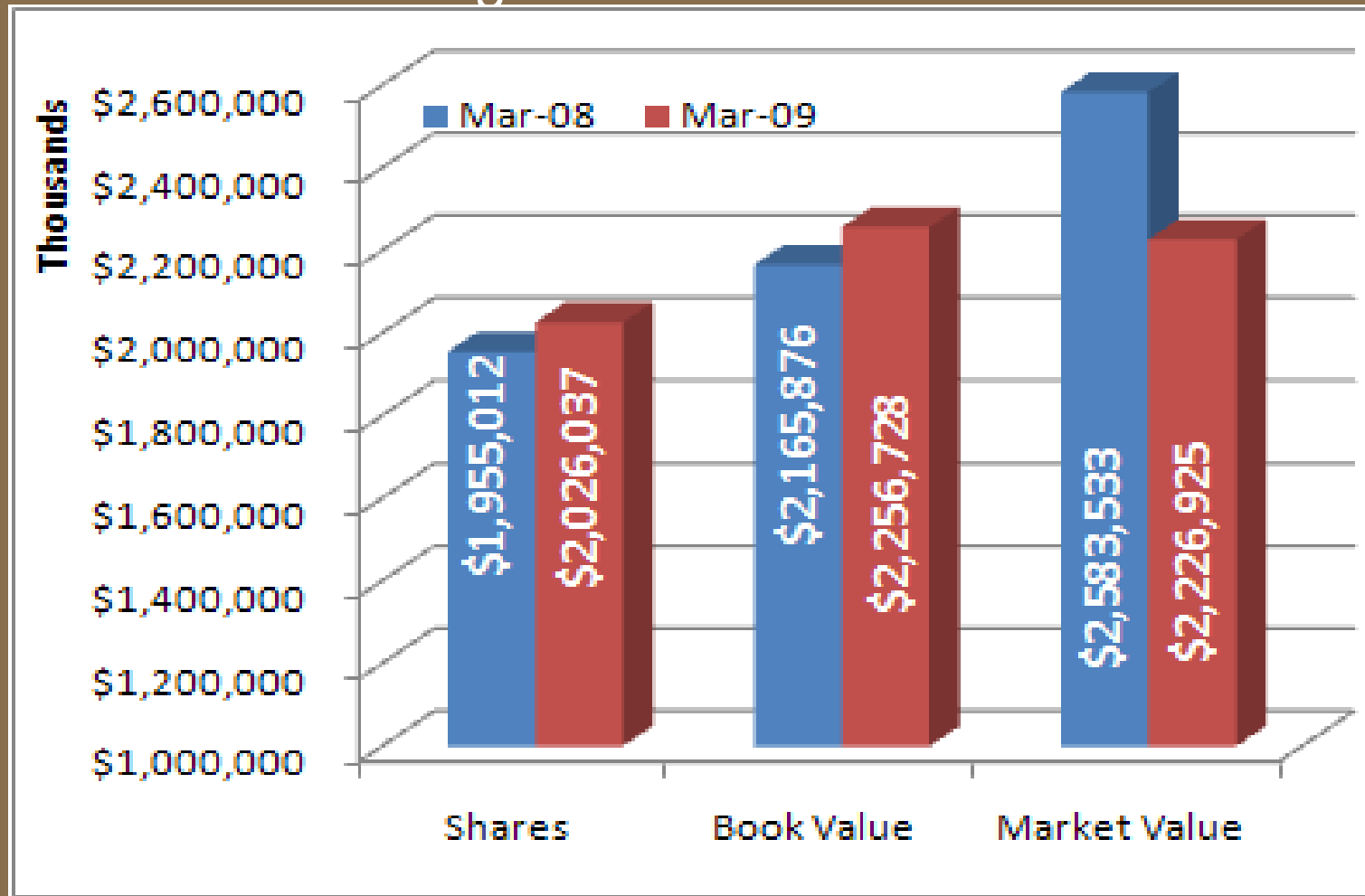
DOW, S&P 500 & 400 Quarterly since 1980



Endowment FY 09 3rd Quarter

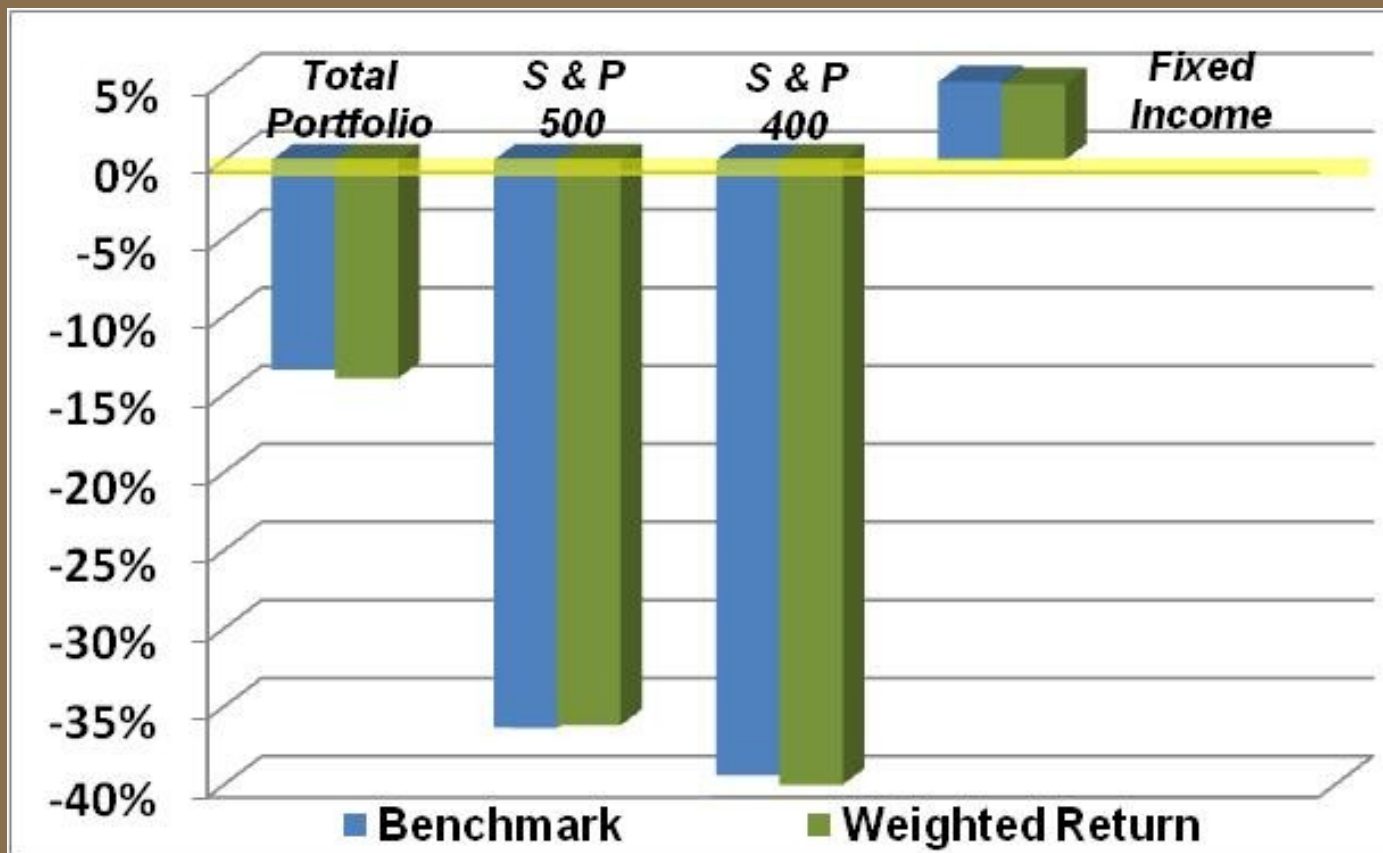
(in Thousands)

Change since FY 2008 YOY



Endowment FY 09 3rd Quarter

(in Thousands)



YTD 2009 Benchmark Comparison

Total Portfolio	S & P 500	S & P 400	Fixed Income
-0.56%	0.15%	-0.72%	-0.92%



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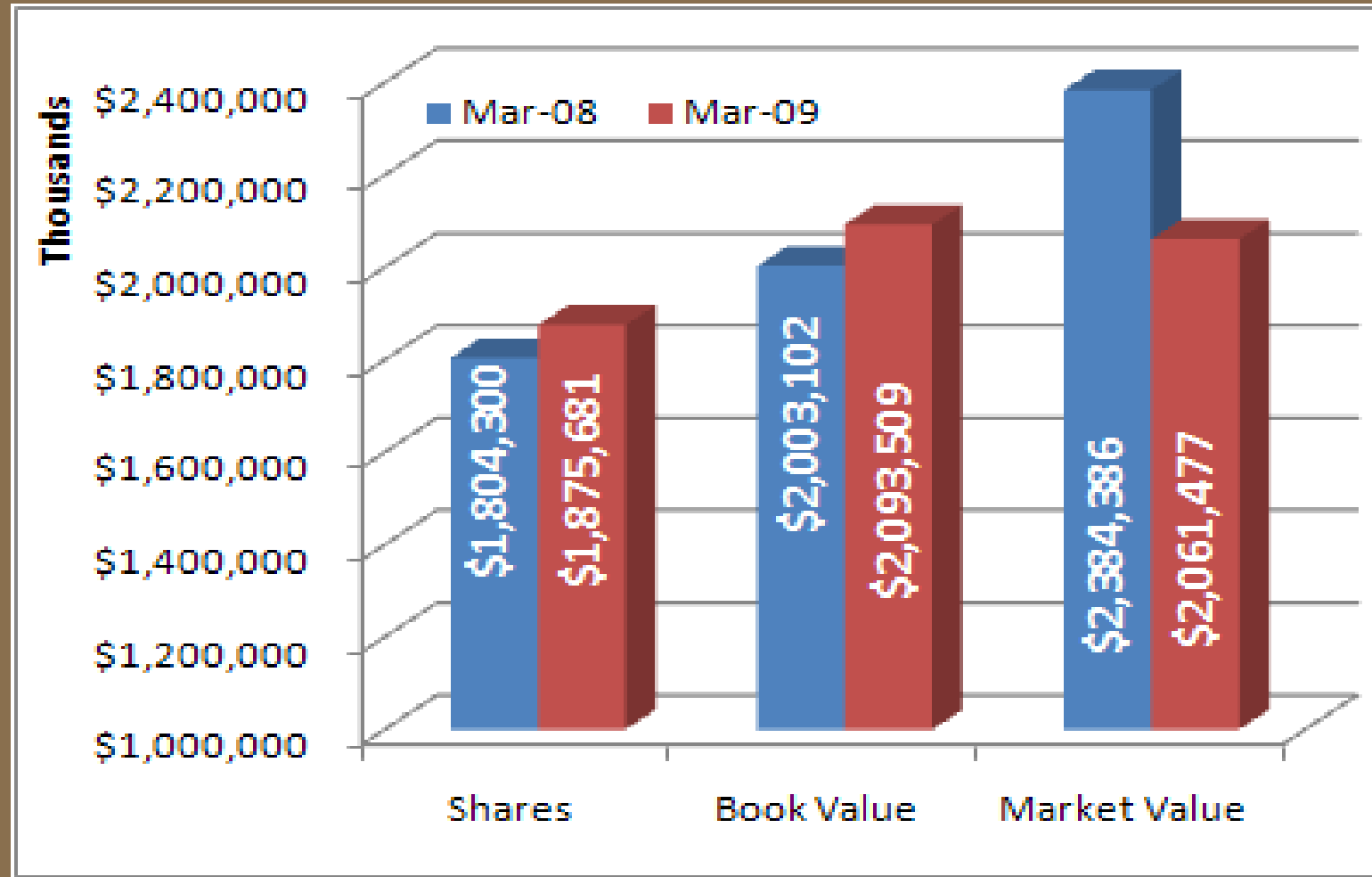
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Permanent Fund

Change in 3rd Quarter YOY (in thousands)



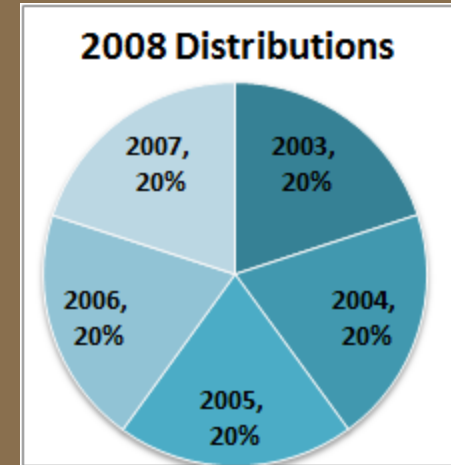
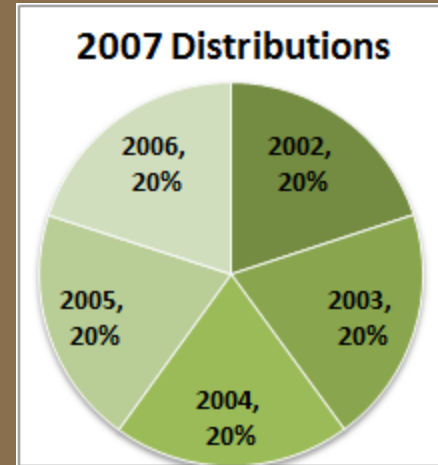
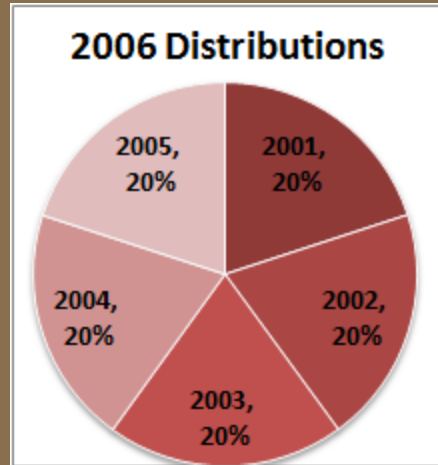
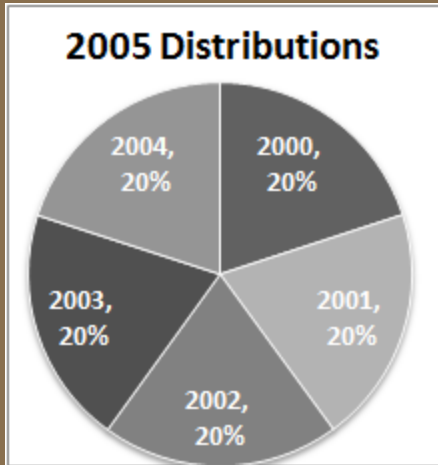
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Distributions are based on a five year rolling average



Beneficiaries receive 20% of each year's earnings (less inflation) for five years.



How the Formula Works

(Permanent Fund example)

YEAR	Rate of Return	GDP Price Deflator	Avg. Market Value
FY 2000	4.71%	2.05%	\$ 870.8 million
FY 2001	4.39%	2.53%	\$ 936.0 million
FY 2002	(0.38%)	1.63%	\$ 968.3 million
FY 2003	6.10%	2.04%	\$ 945.0 million
FY 2004	8.93%	2.92%	\$1,104.5 million
FY 2005	6.59%	2.90%	\$1,374.2 million
FY 2006	4.68%	3.53%	\$1,745.2 million
FY 2007	12.07%	2.77%	\$2,042.9 million
FY 2008	(2.46%)	1.95%	\$2,377.7 million
FY 2009* (3/31/09)	(17.8%)	1.11%	\$2,160.9 million
Average	.61%	2.45%	\$1,938.8 million

5 average of annual rate of return – 5 year average of GDP price Deflator X

Average monthly market value for previous 60 months = Next Year's Distribution



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Constitutional Formula

- Although 5 year performance is positive and producing earnings,
- 5 year inflation average is higher.
- When inflation exceeds earnings, the Constitution & Enabling Act prohibits distributions by the Board of Investments.
- We recommend changing the formula to a much more stable and predictable 2% of market value.
- Prevents wild swings in distributions.
- More predictable distributions to beneficiaries.



How Does Arizona's Endowment Compare To Other Endowments?



How Does Arizona's Endowment Compare To Other Endowments?

FY09 1st & 2nd quarter market value

University of Chicago	Yale Endowment	Harvard Endowment	Boston College
down 25-30%	down 25%	down 22%	down 25%



How Does Arizona's Endowment Compare To Other Endowments?

FY09 1st & 2nd quarter market value

University of Chicago	Yale Endowment	Harvard Endowment	Boston College
down 25-30%	down 25%	down 22%	down 25%

**Arizona State Land Trust Endowment
Relative Market Value Change Outperformed By:**

17-26%	17%	13%	17%
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How Does Arizona's Endowment Compare To Other Endowments?

FY09 1st & 2nd quarter market value

Average University Endowments down 24%

**Arizona State Land Trust Endowment
Relative Market Value Change Outperformed By:**

16%



Our Investment Philosophy

SAFETY
before
LIQUIDITY
before
YIELD

IT WORKS!



Questions?

Please use chat or phone
remember to identify yourself!

THANK YOU

We Appreciate Your Business!!!

Next Quarterly Meeting:

Thursday, July 30, 2009 1:30pm

